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**BANCA NAZIONALE DEL LAVORO AFFAIR AND
REGULATION AND SUPERVISION OF U.S.
BRANCHES AND AGENCIES OF FOREIGN BANKS**

**HEARING
BEFORE THE
COMMITTEE ON BANKING, FINANCE AND
URBAN AFFAIRS
HOUSE OF REPRESENTATIVES**

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

OCTOBER 16, 1990

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CONTENTS

Hearing held on:	Page
October 16, 1990.....	1
Appendix:	
October 16, 1990.....	66

WITNESSES

TUESDAY, OCTOBER 16, 1990

Charamella, Robert L., Vice President, Insurance Division, U.S. Export— Import Bank.....	16
Dickerson, F. Paul, General Sales Manager and Assistant Administrator for Export Credits, Foreign Agricultural Service, U.S. Department of Agricul- ture	10
Fritts, Paul, Director, Division of Bank Supervision, Federal Deposit Insur- ance Corporation (FDIC).....	60
Gilleran, James, Superintendent of Banks for the State of California	61
Kline, John B., Deputy Commissioner for Supervision, Department of Bank- ing and Finance.....	35
Lombardi, Pietro, Executive Vice President and Regional Manager, North America of Banca Nazionale del Lavoro	37
Mendelowitz, Allan I., Director, International Trade, Energy and Finance Issues, National Security and International Affairs Division, U.S. General Accounting Office.....	18
Smith, H. Terry, Senior Vice-President, Supervision and Regulation, Federal Reserve Bank of Atlanta	33
Steinbrink, Stephen R., Deputy Comptroller for Multinational Banking, Office of the Comptroller of the Currency.....	57
Taylor, William, Staff Director, Division of Banking Supervision and Regula- tion, Board of Governors of the Federal Reserve System	41
Wiley, Marshall, president, U.S.-Iraq Business Forum	7

APPENDIX

Prepared statements:	
Charamella, Robert L.	88
Dickerson, F. Paul with attachments.....	70
Fritts, Paul	143
Gilleran, James E. with attachments.....	160
Gonzalez, Hon. Henry B.....	66
Lombardi, Pietro.....	110
Mendelowitz, Allan I. with attachments	94
Smith, H. Terry with attachments	119
Steinbrink, Stephen R.	156
Taylor, William.....	196
Wiley, Marshall	210

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Civil Action: Banca Nasionale Del Lavarò v. Christopher Drogoul and Paul Von Wedel, U.S. District Court for the Northern District of Georgia, Octo- ber 12, 1989.....	349
---	-----

IV

	Page
Correspondence between Chairman Henry B. Gonzalez and Hon. Dick Thornburgh, Attorney General	238
Information provided to the committee by E. D. Dunn, Commissioner, Georgia Department of Banking and Finance.....	318
Information provided to the committee by Hon. Alan Greenspan, Chairman, Board of Governors of the Federal Reserve.....	266
Information provided to the committee by Hon. John P. LaWare, Member, Board of Governors of the Federal Reserve.....	277
Information provided to the committee by Peter M. Philbin, Deputy Superintendent of Banks, State of New York	309
Information provided to the committee by Robert L. Clarke, Comptroller of the Currency	242
Joint Statement of Principles on the Coordination of Applications for Offices, Examinations, Enforcement Actions, and the Exchange of Information on Foreign Banking Corporations; June 1, 1990.....	347
Letters of Invitation	216
Letter to Chairman Henry B. Gonzalez from Hon. William S. Sessions, Director, FBI, dated October 5, 1990.....	241
Letter to Hon. John Joseph Moakley from James B. Watt, President, Conference of State Bank Supervisors, dated September 19, 1990.....	346
Membership List, United States-Iraq Business Forum.....	209
Selected newspaper articles	340
Translation of proceedings of a special committee of the Italian Senate, May 22, 1990.....	328

BANCA NAZIONALE DEL LAVORO AFFAIR AND REGULATION AND SUPERVISION OF U.S. BRANCHES AND AGENCIES OF FOREIGN BANKS

Tuesday, October 16, 1990

**HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS,
*Washington, DC.***

The committee met, pursuant to call, at 9:30 a.m., in room 2128, Rayburn House Office Building, Hon. Henry B. Gonzalez [chairman of the committee] presiding.

Present: Chairman Gonzalez, Representatives Annunzio, Hubbard, Oakar, Barnard, Schumer, Kennedy, Weiss, Wylie, and Leach.

The CHAIRMAN. The committee will please come to order.

This morning is part of a week that is quite hectic. And the House is going to be like it was late last night, in session, and we probably will be getting roll call votes.

The Banking Committee is meeting today to hear testimony regarding the BNL scandal involving the Atlanta branch or agency of the Banca Nazionale del Lavoro BNL.

This is a sensational case now in the light of events of recent date, in which former employees of the branch, through the BNL, approved approximately close to \$3 billion in what turned out to be secret and unauthorized loans or letters of credit to Iraq.

Only \$67 million of this amount was reported to the State and Federal bank regulators. BNL-Atlanta also failed to report \$1.8 billion in monies borrowed in the world money markets to support the concealed loans. Press reports and the Italian government have linked BNL financing to companies that sold armaments to Iraq over the past several years.

At this time, this committee has no proof of that assertion, and we are not necessarily weighing our hearings in that direction because our prime legislative purpose, and the only and single reason for the hearings and this committee's concern and exertion of its regulatory, that is oversight responsibilities, is a question of legislation with respect to the obviously inadequate regulatory system in our country.

But at a minimum, the secret loans mentioned above increased Iraq's credit capacity and permitted Iraq to spend their scant hard currency on some of the very weapons that are now armed. And

God only knows, and we pray not, but it's beyond our power to decide.

I want to say this, that as an individual from the very beginning in August, I was very critical of the President's decision. It wasn't easy for me because I happen to have a personal liking and high respect for the President.

But I was very concerned, I am, and I appealed to the House leadership to get together with the Senate leadership and call the Congress back into session to exert its congressional and constitutional responsibilities.

My contention is that the President is and has continued to act extra unconstitutionally, and certainly in violation of the very statutes that the Congress has passed as early as 1974. Nevertheless, that is my personal stand. As it turned out, it's been a pretty lonely one.

I believe that now the die is cast, and, of course, in retrospect, it gives this tinge of sensationalism and drama to what at that time was more or less a policy or a cursory banking activity.

The BNL affair is also a case study in regulatory failure, and this is what we are concerned about. The State and Federal regulatory agencies not only failed to adequately supervise BNL, but they still insist they are blameless for not discovering this massive fraud.

The BNL affair raises several larger concerns. For most is the adequacy of the regulatory and supervisory capacity of the U.S. branches and agencies of foreign banks. Entities like BNL command over \$575 billion in assets in the United States right now and over \$7.5 billion of their liabilities are guaranteed by the FDIC.

Now, any American who learns this first who is not aware is shocked and why not, just like in the case of the other events that sorrowfully and sadly and to the detriment of the national interests we have been witnessing here in the last few years.

With this potential, there is nobody in this country, regulator, congressman, or executive branch official that can tell you that at this very moment similar activities are not happening right now because with this vast amount in this realm of ours, the United States, unregulated, unsupervised, and unaccounted to all intents and purposes, unlike any other country, most countries have screening agencies and boards and bureaus. We don't.

The regulatory scheme governing branches and agencies of foreign banks is spelled out in the International Banking Act of 1978. Let me say to my colleagues here that that Act resulted from the 1975 hearings that I was able to generate enough support to get the then chairman of the subcommittee to come to my home town of San Antonio and conduct over a 2-day period and gave rise then to the absence of legislation involving the cross border transactions and the resulting indictment of not only banking individuals but other Federals.

And so the 1978 Act 3 years later actually was fragmentary and actually targeting, you could almost say, the intraborder flow here in this forum.

Now, nationally there are a lot of gaps. The Banking Committee is quite concerned that the present sharing arrangement between

the State and Federal bank regulatory agencies is inadequate to ensure these entities are properly supervised. This is certainly the case in the BNL affair. It's apparent that a thorough review of the International Banking Act is in order.

The BNL affair also raises the issue of whether or not we should allow U.S. based financial institutions to have the potentiality to be used as a conduit of foreign policy. It's time the committee delved into the intentions of foreign banks, especially those owned by foreign governments and the role they play in our economy.

We should ask ourselves, even if it did not happen in the case of BNL, should we permit this arrangement to carry out the type of policies through our banking system, especially if it's against at any subsequent time, or concurrent time, against our own policy?

Should we permit a foreign bank or banks that are underwritten by foreign taxpayers to compete head on with our privately owned banks?

These are questions that are now agitating the minds of enough of our congressmen, on and off of this committee. One must wonder if it's fair for a foreign-government-owned bank to take business and jobs away from our privately owned domestic banks. Maybe it's time we establish a national screening board to monitor more closely foreign bank presence in the United States.

Such a foreign screening board could review applications for foreign bank entry into the United States as well as monitor these banks to ensure they are not engaging in foreign policy activities.

There are several primary reasons that the BNL affair occurred. First, BNL was obviously a pitifully managed organization. An internal 75 page audit of BNL Atlanta that was conducted 1 year before the scandal became public, paints a clear picture of an organization out of control.

This internal audit stated, and I quote, "Based on the audit findings, the Atlanta agency's operations accounting and internal controls were found to be in need of improvement in most areas," end of quote.

The internal audit report goes on to say, and I quote again, "The accounting data preparation and its flow and input into existing systems does not comply with existing BNL practices and procedures and as such is deficient of sound practices and controls," end of quote.

So that in the end result, it was not only the bank in it's affairs, but the Italian national interests and the government that were affected, and obviously adversely.

What is most distressing about the audit finding is that BNL concealed these findings from the State and Federal bank regulators. Upon examining BNL, the State of Georgia asked for a copy of the internal control report. BNL Atlanta management falsely told the Georgia examiners that the report was still in progress and was unavailable.

The State of Georgia examiners never followed up to get a copy of this report until after the raid on BNL. They also did not do their own comprehensive examination of BNL. The State of Georgia gave BNL a clean examination report.

The Federal Reserve Board which has prime responsibility to ensure the State exams are adequate, did nothing to ensure Geor-

gia did a good job. The Fed only spent a few hours on the BNL audit. Ironically, not long after the BNL exam, the manager of the Atlanta branch signed a \$1.155 billion unauthorized loan agreement with Iraq.

Apparently, the BNL people were convinced the examiners would not catch them and that the management of BNL would not detect nor stop them.

This hearing is also being held to acquaint Members with a loophole in the criminal code that today permits employees of non-insured branches and agencies of foreign banks to escape Federal prosecution for bank theft, fraud, embezzlement, misapplication of funds and bribery. The Federal Reserve has asked us to close this loophole, and it's imperative Members understand the reason for this legislative request.

[The prepared statement of Mr. Gonzalez can be found in the appendix.]

With that, we recognize Mr. Wylie.

Mr. WYLIE. Thank you very much, Mr. Chairman.

This is our second hearing on the activities of the Atlanta branch of Banca Nazionale del Lavoro. The staff briefing last week gave us a good overview of unreported lines of credit that were initiated by BNL's Atlanta branch. The giving of unauthorized credit in excess of \$2.8 billion to Iraq raises several important questions.

To what extent did management in New York and Rome know of and approve the Atlanta office's actions? To what extent was the Italian government aware of the bank's involvement with Iraq? And, how should the government regulate and supervise foreign-owned banks that operate in the United States?

You have alluded to that, and I think we might need some assistance in knowing how to go about, perhaps, passing legislation to regulate foreign-owned bank activities here.

I am pleased that we have the State and Federal regulators associated with this case appearing before us today. We will also hear from a representative of BNL. Mr. Chairman, I commend you for holding the hearing and look forward to their testimony.

Thank you very much.

The CHAIRMAN. Thank you once again, Mr. Wylie.

Mr. Annunzio, who happens to be the ranking Member on the majority side of this committee, and also the chairman of the pertinent Subcommittee on Financial Institutions and Supervision, has been active, and in pending legislation we believe we have a pretty good grasp of activities such as this.

However, at this time, it's a pleasure to recognize Mr. Annunzio.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

I want to congratulate you for calling this hearing on the Banca Nazionale del Lavoro, and it's questionable lending practices.

With the International Banking Act of 1978, the United States legislated a policy of national treaty. Foreign banks were essentially allowed to do what United States banks can do. Now a foreign bank has seriously abused this privilege.

A small Atlanta agency of one of the largest banks in the world issued some \$2.9 billion in unauthorized secret loans to, of all countries, Iraq.

I am outraged over this foreign bank's abuse of privilege and the lack of oversight by the regulators. More importantly, the loans and letters of credits were issued to Iraq, a country that is alleged to have used the money to build a weapons plant, to buy western technology. These weapons could be used against our troops in the Persian Gulf.

There are four issues that must be resolved. First, did that agency defy its parental banking office in New York and Rome and lend billions of dollars without their knowledge? If so, did the parent know and overlook the illegal transactions?

Second, where were the regulators during all of this? How could an agency with only a handful of employees hide almost \$3 billion in loans from examiners of the Comptroller of the Currency, the Federal Reserve, and the State of Georgia? The regulators apparently had no idea that BNL was breaking the law.

Third, how did the United States Government come to guarantee the loans and letters of credit to Iraq through the Commodities Credit Corporation? The U.S. Government cannot be expected to finance weapons shipments to a country with which we might go to war any day.

And fourth, BNL is largely owned by the Italian government. This raises issues of competitiveness and accountability. Can U.S. privately-owned banks compete against foreign government-owned banks, even though some of the bank employees have been fired and are the subject of a grand jury inquiry in the United States?

There is an issue of Italian government accountability. Although the Italian Parliament has had hearings on this case and the investigation is expected to continue in Italy, the United States must continue its own investigation.

This case is not just a matter of some lost dollars. For our servicemen and women, it is a matter of life and death. We must get to the bottom of this.

Once again, I congratulate you, Mr. Chairman, for starting the process with these hearings.

The CHAIRMAN. Thank you, Chairman Annunzio.

Mr. Hubbard.

Mr. HUBBARD. Thank you, Mr. Chairman, just a brief statement.

First, to congratulate you upon having this hearing regarding this bank and its questionable lending practices, and also to welcome our witnesses, this panel and the other panels to follow.

That is brief enough. Thank you.

The CHAIRMAN. Thank you.

Mr. Barnard. No statement.

Mr. Schumer.

Mr. SCHUMER. Thank you, Mr. Chairman, and I too want to thank you for having this hearing. As you know, I have been interested in this issue, particularly as it concerns our farm export programs, for quite a long time.

Since 1983 when Iraq began participating in the Commodity Credit Corporation's export guarantee program, the U.S. Government has guaranteed almost \$5 billion of loans to Iraq, ostensibly for the purpose of the export of agricultural commodities to Iraq.

From where we stand today, a nation with over 200,000 of its soldiers standing toe to toe with the bloodthirsty Iraqi war machine,

and with thousands of its citizens held hostage by a ruthless dictator, these 8 years of U.S. largess are shocking, almost incomprehensible.

In effect, we have doled out billions of dollars of free money which enabled Saddam Hussein to build the powerful nation that confronts us today. And all of this could have been accomplished much more easily. The U.S. Government should simply have asked Saddam Hussein what weapons he wanted, ordered them from a manufacturer, paid the bill and shipped them, postage paid to Iraq. If the United States is going to act stupidly, they at least ought to do it simply.

Now that we are at war with Iraq, the U.S. taxpayer will probably be stuck with an over \$2 billion tab for defaulted loan guarantees we so eagerly extended to Iraq. We should have known better.

Yet through the shortsighted conspiracy of agricultural and foreign policy interests, every year from 1983 on, Iraq was allowed to dig deeper and deeper into the pockets of U.S. taxpayers to the point that for this year Iraq was authorized to see \$1 billion in export guarantees, more than one-fifth the total guarantees under this program. They were encouraged, Iraq was, by the Department of Agriculture and the State Department to take more and more and more under these programs.

They were encouraged despite the fact that their crazed leader was supporting terrorism throughout the world, despite the fact that he butchered and gassed thousands of his own people and despite the fact that his human rights record was abysmal.

The Lavoro scandal which we are examining today was just a result of this poorly managed and ill-conceived credit export guarantee program. With the assistance of the GAO I have been for several years closely examining these programs in general, and the Lavoro case in particular with an eye towards reform.

Just last August I asked the GAO to review overall U.S. agricultural assistance to Iraq in the last 10 years, and the role played by government agencies in fostering and encouraging U.S. agricultural assistance to Iraq. The GAO is digging deeply and hopes to complete this review in 2 to 3 weeks. The results promise to be very revealing.

In June 1988 at my request the GAO completed a review of management and operation of the export guarantee programs, and I will just ask in the record that those findings be placed in the record, because they show, GAO told them what to do and they just didn't do it. They didn't care about foreign policy; they didn't care about U.S. interests; all they wanted to do was sell commodities to whoever would buy them, and it didn't even matter if they be paid back or not.

In January of this year I asked GAO to review the last case to assess U.S. exposure and what role the FASs mismanagement played in the scandal, and that review is currently pending.

Mr. Chairman, I want to thank the GAO for its work. The steps have been taken thanks to that work by the FAS to improve programs in their programs and management. This year's farm bill added some necessary statutory reforms which should fix some of the problems. In general, however, I believe that the export credit programs have been a raw deal for the U.S. taxpayer. With the

committee's help, I hope to continue to keep a very close eye on them.

I thank the Chairman.

The CHAIRMAN. Our witnesses today are Mr. Stephen R. Steinbrink, the Deputy Comptroller for Multi-National Banking, Office of the Comptroller of the Currency; Mr. Paul Fritts, Director of Bank Supervision, Federal Deposit Insurance Corporation; Mr. James Gilleran, Superintendent of Banking, California State Banking Department, representing the Conference of State Bank Supervisors.

Gentlemen, thank you very much for your patience, and—well, let's see. Well, I am going by what you all gave me.

Panel one, with respect to U.S. policy towards Iraq and the BNL connection, is Mr. Marshall Wiley, President of the U.S.-Iraq Business Forum; Mr. F. Paul Dickerson, General Sales Manager and Assistant Administrator for Export Credits, Foreign Agricultural Service, U.S. Department of Agriculture; Mr. Robert Charamella, Vice President, Insurance Division, U.S. Export-Import Bank; and Mr. Allan I. Mendelowitz, an old friend of ours, Director, International Trade, Energy and Finance Issues, National Security and International Affairs Division of the U.S. General Accounting Office, or GAO.

Gentlemen, I want to thank you and ask if any one of you has any time problems, either airlines to catch or appointments to keep?

If not, is there any objection we recognize you in the order that we introduced you?

Then we will begin with Mr. Wiley.

STATEMENT OF MARSHALL WILEY, PRESIDENT, U.S.-IRAQ BUSINESS FORUM

Mr. WILEY. Thank you, Mr. Chairman.

The United States-Iraq Business Forum is a trade association of United States companies who had a common interest in doing business with Iraq. It is a tax exempt non-profit corporation organized under Section 501(c)6 of the Internal Revenue Code. In July, 1990, it had a membership of 75 companies, including a number of America's largest corporations. The board of directors included representatives from Mobil, Amoco, Westinghouse, General Motors, Caterpillar, and City Bank of Texas.

The Forum is supported solely by dues from its member companies. It has received no money from the Iraqi government, Iraqi companies, or Iraqi individuals.

The Forum was founded in 1985 for the purpose of promoting United States exports to Iraq. It organized a trade mission to Iraq, hosted receptions for visiting Iraqi officials to which representatives of member companies were invited, assisted member companies in obtaining visas and making the proper business contacts in Iraq, and conducted seminars on doing business in Iraq.

It published a quarterly bulletin and other information on Iraq for distribution to member companies. Membership dues were \$5000 per year for the larger companies and \$2500 per year for the

smaller ones. A list of member companies as of July 1990 is available.

The Forum suspended all activities related to the promotion of trade with Iraq on August 2, 1990. I would add that in addition now the Forum has suspended all activities period, and has gone into a state of total inactivity.

United States-Iraqi commerce has increased steadily since the restoration of diplomatic relations between the United States and Iraq in 1984. The principal constraint on exports to Iraq has been the cash flow squeeze suffered by Iraq as a result of the 8-year war with Iran.

In 1988, the Iraqis estimated that they could clear up the debt created by the war in 5 to 7 years and could then return to their previous practice of paying cash for all imports. In the meantime they asked for 2 years credit terms on most of their imports. Private bank credit for Iraq became increasingly difficult to find and exports to Iraq were, for practical purposes, limited to transactions eligible for government export credit guarantees or to the relatively few high priority items for which the Iraqis were willing to pay cash.

In the longer run Iraq appeared to be an excellent future market for the United States. The regime had ambitious plans for economic development and had a high regard for United States technology and capital goods. They have the natural resources required for balanced development of industry and agriculture. They also have the second largest reserves of crude oil in the Middle East, which could provide the capital needed to finance their development plans.

In 1989, approximately two-thirds of U.S. exports to Iraq were agricultural commodities. The other one-third included a variety of consumer goods and capital goods such as pharmaceutical products, construction materials, automotive spare parts, and water pipe. The agricultural commodities were financed by the credit guarantee programs of the Commodity Credit Corporation of the Department of Agriculture.

In addition, the Export/Import Bank's Foreign Credit Insurance Association (FCIA) provided a \$200 million line of short term credit insurance for exports to Iraq. The FCIA credit insurance was limited to credits of 1 year or less. In a relatively few cases, exporting companies accepted delayed payment terms of 1 or 2 years on their own account.

There were also a few transactions financed by European banks without credit guarantees but at extremely high rates of interest. Very few U.S. banks were willing to confirm Iraq's letters of credit or extend credit to Iraq without credit guarantees. Some high priority items were purchased by Iraq for cash.

The business and financial community viewed Iraq as a potentially important trading partner for the United States. Iraq's banking system and its payments record were considered excellent prior to the Iraq-Iran war. After the war began in 1980, Iraq first drew down its substantial reserves but by 1982 payment problems began to develop. These were exacerbated in 1985 when the price of crude oil declined sharply.

At this time Iraq negotiated a series of bilateral debt rescheduling agreements with individual countries, but refused to engaged in a multi-lateral rescheduling exercise, apparently in the belief that Iraq had more leverage in bilateral negotiations. The international banking community, however, viewed Iraq's behavior as discrimination between creditors, and private bank credit for Iraq became increasingly difficult to find.

Iraq's leadership, on their side, believed that the Western world was not sufficiently appreciative of Iraq's costly efforts in checking Iranian aggression of Iraq's costly efforts in checking Iranian aggression into the oil rich area to the west of the Gulf. They believed that they would be able to obtain government guaranteed credits which, when combined with their substantial oil export earnings, would give them enough foreign exchange to work their way out of their cash flow squeeze without multi-lateral rescheduling.

The Iraqis have never released official figures on their debt, but it has been estimated at approximately \$80 billion, of which approximately \$35 billion is in the form of "hard" debt to trading partners in Europe, Asia, and the United States which will need to be repaid. The balance is "soft" debt to the oil exporting Arab states pursuant to loans which most analysts believe were understood by all parties as "de facto" grants which will never be paid.

In 1990, Iraq's cash flow situation worsened as oil prices dropped and western governments became increasingly reluctant to provide credit guarantees for loans to Iraq. The Iraq leadership apparently began to believe that Kuwait was conspiring with the United States and other Western governments to damage the Iraqi economy. They could not understand why a rich country like Kuwait would exceed its OPEC quota and drive down the price of oil unless it had a hostile intent towards Iraq.

The U.S. decision to suspend the issuance of CCC credit guarantees for Iraq in January, 1990, probably added to their suspicions of a hostile conspiracy. These suspicions were probably a factor in their final decision to invade Kuwait.

The Iraq government prohibited foreign investment in Iraq except by nationals of other Arab countries. During the past 2 or 3 years, Iraqi government officials have indicated that the law might be waived on a case-by-case basis for joint ventures with American firms. To my knowledge no such joint venture has been formed. Some American companies may still have machinery or equipment in Iraq which was sent there to carry out turnkey or construction projects. There is, however, no significant American equity investment in Iraq.

In my opinion, the U.S. Government's commercial policies toward Iraq prior to the invasion of Kuwait were prudent. We did not give Iraq foreign aid nor did we sell Iraq arms or ammunition throughout their long war with Iran even during periods when it appeared that Iran might win the war. Our Commodity Credit Corporation and Eximbank programs were designed to help American exporters reach an important market—not to help Iraq.

Iraqi assets in the U.S. and most other countries are now frozen and Iraq has, in turn, suspended payments on its foreign debt. The U.S. Government will now need to make good on its credit guaran-

tees but it is still possible that a resolution of the Gulf crisis will lead to negotiations and a mutually satisfactory settlement of these claims.

However the current crisis is resolved, Iraq will emerge as an important economic factor in the Middle East. It has the land, the water, the resources and the infrastructure required for rapid development and has the oil reserves needed to pay the bills. The population is relatively well educated and Iraqis have a high regard for American technology and management.

In brief, there is a natural "fit" between the U.S. and Iraqi economies that would permit a mutually beneficial commercial relationship between our two countries when and if we decide that such a relationship should be resumed.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Wiley can be found in the appendix.]

The CHAIRMAN. Thank you for your statement, which we received. I will also ask that the membership list that you provided with your statement be provided in the record at this point.

[The information referred to can be found in the appendix.]

The CHAIRMAN. Mr. Dickerson.

**STATEMENT OF F. PAUL DICKERSON, GENERAL SALES MANAGER
AND ASSISTANT ADMINISTRATOR FOR EXPORT CREDITS, FOREIGN
AGRICULTURAL SERVICE, U.S. DEPARTMENT OF AGRICULTURE**

Mr. DICKERSON. Mr. Chairman and members of the committee, I would like to thank the committee for inviting me to appear today and present the views of the U.S. Department of Agriculture and the Commodity Credit Corporation regarding the concerns that have surfaced in the last year as a result of the investigation of the Atlanta agency of Banca Nazionale del Lavoro.

I know that the committee has already been briefed by its staff regarding the issues and allegations surrounding the Atlanta investigation of BNL, and I will not go into great detail about those matters.

The basic facts, as we now understand them, are these: At some point in the mid-1980's, the management of BNL Atlanta entered into an agreement to loan a large amount of money—rumored to be in excess of \$2.1 billion—to the government of Iraq and its instrumentalities. We are told that BNL's central management in Rome insists that it had no knowledge that the Atlanta branch had committed to make these loans to Iraq, and that the amount pledged was far in excess of the lending limits established for the Atlanta branch.

According to BNL, the loans were concealed from both the bank's regional management in New York and its central management in Rome, and that the loan arrangement with Iraq represented "rogue" activity by the Atlanta branch personnel. This allegedly unauthorized loan activity was purportedly conducted on a secret set of accounts—or "greybook"—and the loans were financed through an intricate scheme of borrowing in the interbank money markets.

At the time the Atlanta investigation was first brought to CCC's attention in September, 1989, BNL held approximately \$750 million in receivables due in the future from Iraq, representing payment obligations under letters of credit that had been assigned to BNL by U.S. agricultural exporters and for which payment guarantees had been issued by CCC under the GSM programs. Because Iraq continued to pay on those obligations up until August 2 of this year, the outstanding obligations of Iraq held by BNL and guaranteed by CCC have been substantially reduced, and today total approximately \$347 million.

Those letters of credit had been issued by Bank Rafidain, an instrumentality of the government of Iraq. To CCC's knowledge, Iraq had made payments on all of its GSM-102 obligations, including all payments due under letters of credit assigned by exporters to BNL up until the time of the invasion of Kuwait. As of August 1, however, Iraq (and bank Rafidain) have stopped making payments on obligations owed to the United States, and CCC has been notified by a number of banks, including BNL, of Iraqi default on GSM-guaranteed transactions.

So that the committee can appreciate CCC's specific interest in the BNL-Atlanta situation, I would like to describe briefly just how the GSM export credit programs work.

The GSM-102 and GSM-103 programs are export credit guarantee programs operated by the CCC under the general authority of section 5(f) of the Commodity Credit Corporation Charter Act of 1948, by which CCC was directed by Congress to develop programs to "export of cause to be exported, or aid in the development of foreign markets for, agricultural commodities." Congress did not provide specific guidance regarding the means for carrying out this mandate, leaving the formulation and operation of specific programs to the judgment and discretion of CCC.

The GSM programs evolved in the 1970's from the need to find export markets for the increasing levels of U.S. farm production. The concept was to develop programs which would permit U.S. agriculture to develop, and establish itself in, new markets. USDA saw the potential for additional sales in a number of countries in which significant additional demand would exist if credit were available. These were countries that, due to financial constraints, could not purchase additional amounts in the customary cash markets, but were interested in and able to purchase on credit.

In the 1970's, CCC assisted U.S. exports through the operation of direct credit and blended credit programs. In the early 1980's, CCC devised two programs—GSM-102 and GSM-103—utilizing credit guarantees, thereby permitting CCC to continue to assist U.S. export sales without providing direct credit. Essentially, the CCC guarantee operates to attract credit from the private sector to finance sales of U.S. agricultural commodities, rather than having the government provide credit directly.

The principal and most significant difference between the GSM-102 and GSM-103 programs is the length of credit terms. Under GSM-102, CCC guarantees repayment for credit sales of 3 years or less; under GSM-103, CCC's guarantees cover credit sales of more than 3 but less than 10 years, with 7 years being the typical repay-

ment period. Regulations for the operation of the programs were promulgated and codified at 7 CFR Part 1493.

As part of the Food Security Act of 1985, Congress established benchmark levels at which it expected CCC to operate these programs. In the case of GSM-102, Congress has mandated that CCC make available "no less than \$5 billion" annually in short-term credit guarantees; in the case of GSM-103 intermediate export credit guarantees, Congress established a ceiling level which, for the most recent fiscal year, was \$1 billion.

The programs operate as follows: CCC has identified a number of countries which are appropriate participants in the GSM programs. Essentially, GSM participant countries are those which have potential for additional food purchases, but could not make those additional purchases in the cash markets—examples are Mexico, Algeria, Morocco, and so forth. The determination of participant countries involves an evaluation of long-term food needs, interest in the program, market development opportunity for U.S. commodities, and ability to repay any credit extended.

Because GSM sales must be made pursuant to a foreign bank letter of credit—an issue I will discuss later—CCC also qualifies specific banks in the participating foreign country which are eligible to receive deferred payment letters of credit in conjunction with GSM-guarantee sales.

Prior to the beginning of each fiscal year, USDA, through its commodity divisions and the attache service of the Foreign Agricultural Service, through discussions with foreign countries interested in the programs and with input from the U.S. export industry, identifies the most favorable opportunities for credit sales under the programs. FAS then allocates the amounts of credit guarantees among potential participating countries, establishing specific country "lines" by commodity. These proposals are presented to an interagency group—the National Advisory Council on International Fiscal and Monetary Policy (NAC)—for its advice.

Once country lines have been established, they are announced to the trade. An exporter who makes a credit sale to a GSM participating country on appropriate terms can apply, in accordance with the terms of the program regulations, for a CCC payment guarantee. If there is sufficient credit guarantee available for the commodity and country identified in the sale, CCC will issue a provisional export credit guarantee to the exporter. The guarantee becomes effective at the time the commodities are exported from the United States.

Under the program regulations, sales must be made subject to repayment on deferred terms under a letter of credit issued by an approved foreign bank. The CCC guarantee is a promise to the exporter that CCC will pay the exporter, or its assignee, for the sale in the event that the approved foreign bank should default on its payment obligation under the letter of credit.

It is important for the committee to understand that this is the only risk assumed by CCC under the GSM program—the risk of nonpayment by an approved foreign bank issuing an international letter of credit.

Once the exporter receives the GSM guarantee and has exported the commodity in accordance with the terms of its letter of credit

obligations, it is free to "assign" its rights to proceeds under the letter of credit (and its rights to receive payment under CCC's guarantee in case of default) to a U.S. financial institution.

The CHAIRMAN. Mr. Dickerson, will you please yield to me at this point?

We have notice of a recorded vote, and we are going to allow the Members time to go and record their vote and come back immediately. So we will recess for about 10 minutes or so.

[Vote recess.]

The CHAIRMAN. The committee will come to order.

Mr. Dickerson, we apologize for the delay, but we do have these things happening, as I said at the outset.

Mr. DICKERSON. Thank you, Mr. Chairman. If I may continue.

Put more simply, this "assignment" of rights means that the U.S. exporter is able to receive immediate payment for its sale from a U.S. bank and "cash out" of the transaction. Most banks that take such assignments then book these transactions as "loans" made to the foreign bank that is obligated to make deferred payments under the letter of credit. The risk of repayment is passed to the U.S. bank which effectively undertakes to finance the credit sale.

This is, of course, the entire purpose of the program. U.S. exporters are ordinarily not in (and do not want to be in) the business of financing credit sales; the purpose of the GSM programs, as I mentioned earlier, is to attract marketplace financing.

The committee should also note that CCC does not issue credit guarantees to U.S. banks. Guarantees are issued to the agricultural exporters, who subsequently negotiate the guarantees to financial institutions interested in having these types of "loans" in their portfolios. As a result, CCC has no programmatic relationship with banks located in the United States under the GSM-102 and GSM-103 programs, nor any regulatory oversight.

More importantly, CCC assumes no risk whatsoever with respect to the U.S.-based financial institutions that take assignments of GSM guarantees. Whether the guarantee is held by the exporter or by its assignee, CCC's risk remains identical—it is the risk of non-payment by the foreign bank issuing the letter of credit. Accordingly, the only requirement imposed with respect to assignment is that the assignee be a financial institution located in the United States.

Iraq began purchasing U.S. commodities under the GSM program in 1983 when the United States and Iraq were working to re-establish diplomatic relations that had been severed for almost 17 years. Iraq was, at that time, engaged in the middle of its 8-year war with Iran and was looking for a means of obtaining food and feedstuffs on credit. At the same time, the United States was experiencing a surplus of many commodities, and it was determined that Iraq's long-term food needs presented significant market development potential for a number of U.S. commodities.

In 1983, Iraq purchased \$364 million of U.S. agricultural commodities under the GSM-102 program. The program grew in most years during the 1980's, with peak allocations during fiscal year 1988 and fiscal year 1989 of slightly more than \$1 billion annually.

A summary of the export values guaranteed during the period is set forth in Attachment A.

As part of the process of establishing country allocations, representatives of USDA ordinarily held consultations with representatives of Iraq each year in the late summer or early autumn to determine Iraq's specific interests in GSM purchasing. These consultations were held either in Baghdad or Washington.

Because Iraq is a centrally planned economy, all of its GSM purchasing was conducted through various government ministries. The Iraqi delegations to these consultations were ordinarily led by officials of the Iraqi Ministry of Trade, and included representatives from the various purchasing ministries. The U.S. delegation consisted of representatives of CCC's Office of the General Sales manager and of FAS officials in charge of program operations. Oftentimes, U.S. officials also met with representatives of the involved Iraqi financial institutions—the Central Bank of Iraq and Bank Rafidain.

From the time the program for Iraq was initiated in 1983 until the invasion of Kuwait, Iraq purchased approximately \$5 billion in U.S. agricultural commodities under the GSM programs. CCC records indicate that it did not receive any claims or incur any losses with respect to guarantees issued in conjunction with sales to Iraq. Based on the value of guarantees issued over that time period which have lapsed without the filing of any claims, CCC estimates that Iraq paid approximately \$3 billion in principal amounts due plus interest.

On a few occasions, CCC did receive notice of late payment from assignee banks; however, on each of those occasions, it was determined that the late payment had occurred because of difficulties in the international funds transfer process, and within a very short time, payment was received and Iraq was determined to be current on its GSM-guaranteed obligations. I would note that CCC received no claims on guarantees issued in conjunction with Iraqi sales even after the BNL investigation began in Atlanta up until August 1 of this year.

This situation has now changed drastically. As of August 1, Iraq stopped payment on all of its foreign debts. Unpaid Iraqi obligations for which CCC has issued guarantees under the GSM-102 or GSM-103 programs total approximately \$2 billion. This represents approximately \$1.6 billion in principal obligations, and the remainder in guaranteed interest.

The majority of these obligations result from sales made under the GSM-102 program, and those obligations will come due over the next 3 years. A smaller percentage—less than \$200 million—represents repayments on sales made under the GSM-103 program which will come due over the next 5 years.

The receivables for those obligations, and the rights to proceeds under GSM guarantees, are currently held by eleven different U.S.-based banks, some of which are U.S. banks and some of which are U.S.-based branches or agencies of foreign banks, including BNL. CCC is authorized to accept and pay on valid claims, and is currently in the process of evaluating all claims on a case-by-case basis.

According to CCC records, BNL currently holds receivables, for which CCC guarantees have been issued, of approximately \$347 million. In addition to the GSM-guaranteed financing it provided in conjunction with sales to Iraq, BNL has also financed GSM-guaranteed sales to seven other countries, totaling approximately \$242 million.

After the U.S. Attorney in Atlanta began its investigation of BNL last year, CCC took several actions.

First, it was determined that only \$500 million of credit guarantees should be allocated to Iraq, which represented about one-half of the level requested by Iraq and about one-half of the level allocated in each of the prior fiscal years.

Second, CCC initiated an administrative review of the program with Iraq to determine, based on the information available to CCC, whether there might have been any program abuses associated with the transactions for which BNL had accepted assignment of proceeds.

When the Atlanta investigation began, very little was known about what might have transpired at BNL. In general, it appeared that the investigation involved primarily issues of bank fraud and evasion of bank regulatory requirements. There was no information available for CCC to determine whether BNL had been involved in any irregularities with respect to any CCC-guaranteed transactions.

For that reason, CCC initiated its own administrative review of the GSM program with Iraq. That process involved review of BNL's GSM records, certain exporter records, historical commodity prices and CCC records. In addition, I headed a team which traveled to Baghdad in April to review Iraqi records and to meet with Iraqi officials within the Ministry of Trade. The report of that administrative review was released publicly in May, 1990, and a copy has been provided to your staff.

In addition, an executive summary of the findings and conclusions of that review are provided with this statement as Attachment B.

As you will note from that summary, one area of concern was the issue of so-called "after sales service." In CCC's administrative review, it was learned that Iraq had a fairly regular practice of requesting that U.S. exporters operating under the GSM program provide rebates or discounts, often in the cases of additional goods such as truck tires or equipment.

It appears that, in some cases, exporters failed to reduce the "port value" reported to CCC at the time guarantees were obtained by the value of these additional goods, which failure would represent a program violation on the part of the exporter. At the conclusion of its review, CCC turned over the information it had developed to USDA's Office of the Inspector General, asking that it conduct a thorough investigation of all sales to Iraq to ascertain the extent of this practice.

The OIG is completing its study and we expect a final report soon. CCC will take appropriate administrative or civil action in the event that the OIG report discloses wrongful violation of program requirements.

In conclusion, I would note the following points for the committee:

First, in the absence of a settlement to the current crisis in the Mideast, CCC expects that Iraq will continue to default on its obligations to U.S. banks for which repayment has been guaranteed by CCC under the GSM-102 program. Potential exposure to CCC as a result of those guarantees is approximately \$2 billion. CCC exposure is a result of nonpayment of obligations by Bank Rafidain under letters of credit issued by that bank.

Second, CCC is continuing to monitor the investigation of BNL in Atlanta to learn whether any program violations uncovered in that investigation will require appropriate administrative or civil action. However, because CCC does not assume any risk with respect to U.S. banks, CCC's potential exposure relates to nonpayment of obligations by Iraq and is unaffected by the circumstances that are under investigation at BNL Atlanta.

I would like to thank the committee for this opportunity to appear before it, and would be happy to respond to any questions.

[The prepared statement of Mr. Dickerson can be found in the appendix.]

The CHAIRMAN. Thank you, Mr. Dickerson.

The Chair will say that we have about eight witnesses after this, and we are very grateful for those of you that gave us your prepared text. But the Chair would implore that if it is at all possible, to be succinct and abbreviate the testimony as much as possible, it will allow us to proceed expeditiously and not keep the other witnesses too late.

Mr. Charamella, the entire statement that you have given us will be made a part of the record, so that you may proceed by summarizing, whichever way you see fit. But I would implore you to be as succinct as possible.

STATEMENT OF ROBERT L. CHARAMELLA, VICE PRESIDENT, INSURANCE DIVISION, U.S. EXPORT-IMPORT BANK

Mr. CHARAMELLA. Thank you, Mr. Chairman. I will summarize our statement.

I welcome the opportunity to be here today to discuss Banca Nazionale del Lavoro, and Iraqi participation in the Export-Import Bank programs. We at the Bank have carefully reviewed how both parties used our programs, and I am pleased to share our findings with the committee.

The Bank is, of course, no longer open in Iraq. U.S. exports were banned to Iraq pursuant to Executive Orders dated August 2, 1990, and August 9. Eximbank's board of directors formally withdrew coverage on August 9, 1990.

From July, 1987, to August 2, 1990, Eximbank was open in Iraq for short-term insurance cover only (up to 360 days), up to a relatively modest aggregate principal exposure limit of \$200 million. We were "off cover" for the preceding 16 months due to payment delinquencies which were paid in full prior to our re-opening that July.

In 1987, we opened cautiously in Iraq only for short-term insurance despite tremendous pressure from the American business community as well as competition from foreign Export Credit Agencies who were open for short, medium and long-term cover in

Iraq. Since 1987, the government of Iraq has continually requested that we expand our cover to medium-term and long-term transactions; however, we declined. We never allowed our Iraqi exposure to get out of hand due to the low exposure limit set by the Eximbank board of directors.

Eximbank's willingness to continue its short-term cover in Iraq was based on Iraq's willingness and ability to service its existing debt to the U.S. Government and Eximbank/FCIA in a satisfactory manner.

The current Eximbank exposure in Iraq is \$73.5 million, of which \$55 million is for amounts outstanding and \$18.5 million represents potential exposure.

The potential exposure of \$18.5 million relates to shipments which did not take place before August 2. Since U.S. exports to Iraq were banned as a result of the Executive Order dated August 2, no further shipments are expected to take place—thus, related Iraqi letters of credit are not expected to be negotiated. Consequently \$18.5 million of exposure will be taken off our books.

With regard to claims which Eximbank has paid because of Iraq's failure to pay, we have paid only one small claim of \$53,000. This was in July and resulted from the nonpayment of some post maturity interest which was disputed by the Iraqi opening bank. Prior to August 2, we were negotiating with the Iraqi bank and were confident that it would be resolved in a satisfactory manner.

It does appear very likely that we will have to pay claims in the near future for the \$55 million of actual exposure which I mentioned. How will these claims be treated? These claims will constitute a purchase of assets, which we hope to work out with the Iraqis at some future date.

Mr. Chairman, you asked that I explain BNL participation in Export-Import Bank programs—and, I will do that now. We offer Eximbank programs to financial institutions which are determined to be creditworthy as required by the Export-Import Bank Act of 1945.

After review of BNL's financial standing and operations abroad and in the United States, Eximbank programs were made available to the BNL offices in Rome, New York and Atlanta.

The BNL-Rome office acted as guarantor for two medium term transactions in the mid-1970's in the aggregate of approximately \$4 million which was disbursed and repaid in a satisfactory manner.

The U.S. branches of BNL have not used the Eximbank medium-term and long-term programs.

BNL-New York has used the Eximbank Working Capital Guarantee Program for 10 transactions. The aggregate value of these transactions is \$5.7 million, and experience has been satisfactory.

BNL-Atlanta received a Bank Letter of Credit policy which was used to insure Iraqi letters of credit, in the manner I described previously. This policy expired on December 31, 1989. BNL was the insured for 51 transactions which aggregated \$47 million—\$43.8 million has been repaid satisfactorily. There is currently \$3.2 million outstanding to BNL which is included in the \$55 million of actual exposure to Iraq and will likely result in a claim.

Those are the results of our review. I would be happy to answer any questions the committee may have.

[The prepared statement of Mr. Charamella can be found in the appendix.]

The CHAIRMAN. Thank you, Mr. Charamella. We deeply appreciate the dispatch with which you summarized.

Mr. Mendelowitz, again, we want to thank you for being with us; you have been helpful to this committee before and we are deeply grateful.

STATEMENT OF ALLAN I. MENDELOWITZ, DIRECTOR, INTERNATIONAL TRADE, ENERGY AND FINANCE ISSUES, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. MENDELOWITZ. Thank you, Mr. Chairman. I too will be happy to read a shortened statement and supply my full statement for the record.

The CHAIRMAN. Thank you.

Mr. MENDELOWITZ. We are pleased to be here today to discuss the management and operations of the Department of Agriculture's Commodity Credit Corporation's Export Credit Guarantee Program and Intermediate Export Credit Guarantee Program, referred to as the GSM-102 and 103 programs respectively. The programs are managed and operated by the Foreign Agricultural Service. In addition to our views on management of the program, you asked that we specifically address Iraq's participation and some issues involved.

In the past few years, we have conducted several reviews of these programs in response to requests from the Senate and House Agriculture Committees and the House Budget Committee's Task Force on Urgent Fiscal Issues. In general we have found that FAS needs to improve its management controls over the programs to better ensure the programs' integrity and to avoid excessive financial risk to the U.S. Government.

Action has been taken on some of our recommendations. For example, CCC has improved its accounting for outstanding loan guarantees, enhanced some internal controls over the programs, and is in the process of recognizing estimated losses in its 1989 financial statements.

However, we believe that further improvements are still needed in tightening internal controls, specifically those related to financial institutions' participation in the programs, and in defining an agricultural commodity eligible for export under the programs.

The success of the GSM-102/103 programs depends greatly on the active participation of financial institutions. These institutions disburse the approximately \$4 billion in GSM loans each year, providing direct credit to the foreign buyers.

Despite the important role played by the institutions, CCC has only two regulations covering their GSM-related activities. The first is that participating institutions must be located in the United States. The second prohibits a participating U.S. financial institution from being affiliated with the overseas bank issuing the letter of credit, which the foreign buyer uses to pay for the commodities exported under the GSM programs.

Although the second regulation prohibits participation in transactions by affiliated banks, it does not fully protect U.S. interests from other less-than-arm's-length relationships. CCC has guaranteed the financing of exports to foreign governments who were also owners of the U.S. institutions lending the money and receiving the GSM guarantees.

During a recent review, we found three U.S.-based financial institutions that were either directly owned by or otherwise affiliated with government-owned banks in GSM customer countries.

In fact, two of these three financial institutions held guaranteed debt on which their foreign government owners defaulted. One institution is owned by a consortium of several banks and 43.7 percent of its equity is owned by a defaulting government's central and nationalized banks. The other institution is also owned by a foreign consortium and has financed about \$588 million in GSM transactions to one of its owner countries which owns 14 percent of the institution's equity. These loans represent about 62 percent of the institution's total GSM portfolio.

Iraq's participation in the GSM-102/103 programs began in 1983, just before we re-established official diplomatic relations with that country. Iraq was initially allocated \$230 million in loan guarantees under the GSM-102 program to purchase feedgrains, rice, and wheat. The Iraqis were depleting their foreign exchange reserves due to their war with Iran and they desperately needed credit.

In 1984 Iraq's allocation was almost tripled, to about \$680 million. Iraq began importing protein concentrates, tobacco, vegetable seeds, and other commodities in addition to the feedgrains, rice, and wheat. By 1988 Iraq's GSM-102/103 allocations totaled about \$1.1 billion and were used to purchase some 30 different commodities. This level of GSM-102/103 allocations continued in 1989 and the Iraqis sought the same levels in 1990.

However, when the unauthorized loans involving Iraq came to light in the Banca Nazionale del Lavoro case, the Agriculture Department decided to scale back the 1990 program for Iraq to \$500 million, with the possibility of another \$500 million allocation pending results of Justice's investigation of the bank.

Problems identified in the GSM programs for Iraq so far include the following:

Iraq has suspended payment on its approximately \$2 billion in outstanding GSM guaranteed loans, exposing CCC to a substantial loss.

One bank, the BNL, has a high concentration of loans to Iraq, a significant amount of which are guaranteed under the GSM programs. However, most of the GSM guaranteed loans were not authorized by higher level bank officials. Only \$130 million was authorized by the higher bank officials at the time the BNL scandal broke. About half of those outstanding guaranteed loans were repaid by Iraq prior to Iraq's cessation of debt service in the beginning of August with the onset of the current Gulf crisis.

Foreign origin agricultural commodities have been exported to Iraq under the GSM programs. Such exports are contrary to program regulations which state that the guarantees are to be provided for U.S. agricultural commodities. Eight tobacco exporting companies have pleaded guilty to filing false statements with USDA or

customs in connection with sales of tobacco to Iraq or Egypt under the programs and have been fined a total of \$300,000. The companies were also directed to pay restitution costs to CCC of up to \$1.1 million should CCC incur losses related to those shipments.

Money obtained under Iraqi participation in the GSM programs has been used for purposes other than those permitted, including after-sales services that are unrelated to agricultural exports.

Our work in this area is continuing at the request of Chairman Charlie Rose of the Subcommittee on Tobacco and Peanuts, House Committee on Agriculture and Congressman Charles Schumer. Investigations by the Department of Justice and U.S. Customs Service on these issues are also continuing.

Mr. Chairman and members of the committee, this concludes my statement. I will be happy to answer any questions you may have.

[The prepared statement of Mr. Mendelowitz can be found in the appendix.]

The CHAIRMAN. Thank you very much. We will have questions. I will advise my colleagues that we will stick vigorously to the 5-minute rule, beginning with me and proceed.

Mr. Dickerson, in your statement on page 12 you say that, "As you will not from that summary, one area of concern was the issue of so-called 'after sales service.' In CCC's administrative review, it was learned that Iraq had a fairly regular practice of requesting that U.S. exporters operating under the GSM program provide rebates on discounts, often in the cases of additional goods such as truck tires or equipment. It appears that, in some cases, exporters failed to reduce the 'port value' reported to CCC at the time guarantees were obtained by the value of these additional goods, which failure would represent a program violation on the part of the exporter. At the conclusion of its review, CCC turned over the information it had developed to USDA's Office of the Inspector general, asking that it conduct a thorough investigation of all sales to Iraq to ascertain the extent of this practice. The OIG is completing its study and we expect a final report soon. CCC will take appropriate administrative or civil action in the event that the OIG report disclosed wrongful violation of program requirements."

Rebates or discounts, often in the case of additional goods such as truck tires and equipment, isn't that the same thing as a kick-back?

Mr. DICKERSON. I suppose you can use any term you would like to use but the program disallows the inclusion of any kind of rebates or the distribution of any material or goods if there is not an allowance or discount from the port value which we guaranteed.

It is originally common practice in this country as well as in others where there are rebates. We use rebates in this country for new cars. In theory at least that rebate should not be guaranteed as part of the underlying guarantee provided by CCC if the exporter does not reduce the port value in cash or goods, he is in violation of our program.

The CHAIRMAN. Well, through the years and particularly after the advent of the GATT and everything else, we used to have reports from private businessmen doing business even in this new world, in Central and Latin America, that they could not compete

with other foreign salesmen because they always managed to provide a little stipend on the side.

However, the abuse of that—and it was common practice, I had personal friends who were employed by some of the companies doing transnational business here. Pretty soon the Congress had hearings. I forget what committee it was, and we passed the Foreign Corrupt Practices Act.

It was a tradition that if you got to the proper official first and take care of him you got the business. Now what is to prevent such goings on here? If you had not noticed that Iraq was practicing this custom of asking for these extra goodies, which ever way you want to look at it. Common parlance is what we call kick backs. What assurance do we have it doesn't go beyond that? We don't know. I think the fact that even now we are waiting for the inspector general's report indicates that all up and down this whole business was just fraught with questionable practices and all with the best of intentions, that is to foster and stimulate trade and redress the imbalance of trade as they have said all along.

But it seems to me that in this case here, coupled with the fact that the tenuous relationship with another American agency, the Export-Import Bank, which leads to a question here that relates both to you and to Mr. Charamella, and that is that between February of 1986 and 1987, the Export-Import Bank suspended Iraq from proceeding because of delinquencies.

During that same period the USDA approved over \$500 million for Iraq even though Iraq was refusing to pay back the Eximbank. Did the USDA know Iraq was in arrears at that time? How could USDA justify guarantees for Iraq when they were refusing to pay? Wasn't this policy every discussed in the National Advisory Council? Could you comment on that?

Mr. DICKERSON. I personally have no knowledge of that relationship with the Export-Import Bank.

The CHAIRMAN. My time has expired.

Mr. Wylie.

Mr. WYLIE. Mr. Mendelowitz, Mr. Schumer said earlier in his opening statement that he made a request from GAO for an investigation of the CCC some time ago. How long ago was that investigation requested?

Mr. MENDELOWITZ. The request from Congressman Schumer.

Mr. WYLIE. Yes.

Mr. MENDELOWITZ. The request regarding BNL came in last January. The request regarding CCC came in this past summer.

Mr. WYLIE. Did you recommend in your report that we stop trading with Iraq?

Mr. MENDELOWITZ. We did not deal with that issue in the course of our work. The issue of whether we should or should not be trading with Iraq I believe is appropriately a policy issue that falls within the purview and prerogatives of the President and Congress.

Mr. WYLIE. Was there any evidence of kick backs by Exim or CCC or U.S. exporters which came up in the course of your report?

Mr. MENDELOWITZ. The irregularities with respect to the GSM-102 and 103 program have been surfacing in the course of our work since 1987.

For example, we have been warning about the lack of internal controls. The hard evidence on the extent of the after sales services, of if you choose, kick backs, is included in a report that the Department of Agriculture conducted last spring which was generated by the BNL scandal.

Mr. WYLIE. Do you want to respond to that, Mr. Dickerson?

Mr. DICKERSON. The best response I can give you is my participation in the last 14 months I have been with FAS. There has been an effort on the part of the agency to strengthen this program from all aspects. Over the last 12 months we have taken a number of measures which we feel will improve the entire administration of this program including instituting a price review policy, putting exporters on regular notice of the necessity of maintaining proper documentation. We have warned exporters on several occasions about the practice of after sales services being in violation of CCC regulation, a number of different things we have attempted to do to expedite the efficient management and administration of this program and letting the public at large know that on a public announcement basis.

Mr. MENDELOWITZ. Mr. Wylie, I would like to associate myself with those comments by Mr. Dickerson. The reaction in 1987 and 1988 was that there were no problems with the administration of the program. The Administrator of FAS denied there were any problems or there was any validity to the criticisms. Over the past year and a half with the new administration there has been more openness and receptivity to recognizing the problems we have raised.

Mr. WYLIE. What is the extent of the United States' liability through the CCC and Export-Import Bank for loans to Iraq, Mr. Mendelowitz.

Mr. MENDELOWITZ. Eximbank?

Mr. WYLIE. And also CCC.

Mr. MENDELOWITZ. I don't have first-hand information on Eximbank. My understanding with respect to Iraq is that the GSM program has a contingent liability of approximately \$2 billion.

In other words there is \$2 billion worth of export credit guarantees outstanding. Iraq has ceased servicing that debt so claims will be filed.

Mr. WYLIE. So the U.S. has a potential liability of \$2 billion, approximately?

Mr. CHAMELLA. Our total exposure from Iraq is \$55 million.

Mr. WYLIE. Why the difference in opinion as to what the United States exposure is?

Mr. MENDELOWITZ. No, there are two different programs. It would be additive. Our total exposure to Iraq would be the outstanding amounts of the export credit programs for agricultural commodities plus the outstanding amounts under the Eximbank's program for manufactured products. The Eximbank amount is \$55 million so you just add the \$55 million to the agricultural export credit amounts.

Mr. WYLIE. What is the extent of our Kuwaiti exposure?

Mr. MENDELOWITZ. I don't believe we have any GSM-102 or 103 exposure to Kuwait.

Mr. WYLIE. Should U.S. banks guarantee exposure to foreign owned banks?

Mr. MENDELOWITZ. The issue of participation is something we are starting to examine now in response to the requests that we look at that aspect of the programs.

The issue of whether we should be extending guarantees to foreign owned banks is fairly complex. Without bank participation in the program you would not have a program. A very large share of the participating banks turn out to be foreign owned banks.

Mr. WYLIE. My time has expired. I will adhere to the rule.

The CHAIRMAN. Mr. Barnard.

Mr. BARNARD. Thank you, Mr. Chairman.

Mr. Mendelowitz, what do you see in this transaction that you could say was systemic of the entire CCC operation? Is this an unusual transaction with Iraq or is it in your feeling, it is an operation that has problems in its entire operation?

Mr. MENDELOWITZ. Well, I think that the answer to your question is probably yes with respect to both parts of it, without appearing contradictory. The program is at its heart a program to promote the export of U.S. agricultural products and it has been very helpful in that regard. The issue, though, is that the program is not exclusively a program for exporting agricultural commodities.

The program also has foreign policy objectives. The reason why we began I believe back in 1983 extending loan guarantees for agricultural exports to Iraq had as much to do with promoting exports of agricultural commodities as it did with serving foreign policy objectives.

Mr. BARNARD. Why did you say that it is not exclusive with agricultural products? What is the loophole there that permits the other products?

Mr. MENDELOWITZ. It is not that other products are permitted but that there is a foreign policy element in the consideration of the program. For example, my understanding of what happened in the early 1980's was that at some point after the onset of the Iraq-Iran War the U.S. Government decided to tilt toward Iraq and we wanted to give substantive meaning to that tilt toward Iraq. When we looked at what the U.S. Government could do for Iraq we found there was not very much we could do because Iraq was on the list of countries that supported terrorism.

The only things we could do was to provide the export credit guarantees under the GSM-102 and 103 programs.

Mr. BARNARD. Have you verified that that was actually a policy of State on down to the CCC or was that just a coincidence?

Mr. MENDELOWITZ. There are two aspects. CCC does not make decisions in isolation by itself. All program initiatives are presented to an interagency committee, the NAC, in which State, Commerce, Agriculture, Treasury, and so forth, consider it. It comes within the interagency process in which the full range of concerns and interests are considered.

Mr. BARNARD. Mr. Dickerson, do you concur in what Mr. Mendelowitz was saying here?

Mr. DICKERSON. Not entirely. It is USDA program. The determination of whether or not a particular commodity should be directed

toward any country is market driven along with an appropriate measure of risk.

When you refer any program like this to an interagency process, you are going to have consideration by other agencies of government who have input in the ultimate results of that program. But basically, it is market driven as related to risk by the Department of Agriculture.

Mr. BARNARD. You don't generally meet with the Department of State and they advise you you ought to be more liberal with one country than others?

Mr. DICKERSON. We do not. When this comes to the interagency process which reviews each of these allocations there is discussion on the part of every agency and it is considered but it is market driven as related to risk, not foreign policy directed.

Mr. BARNARD. Do I see a contradiction here, Mr. Mendelowitz?

Mr. MENDELOWITZ. There appears to be a conflict.

Mr. BARNARD. Not conflict, contradiction.

Mr. MENDELOWITZ. A number of years back, around 1984, we spent a good deal of time looking into the issue of Iraq—

Mr. BARNARD. Let me ask this question, one of the impetus in us getting into this hearing was the assertions that the invasion of Kuwait was partially financed by the BNL branch in Atlanta as a result of CCC credit.

Can you follow that down to any determination?

Mr. MENDELOWITZ. I don't think you can make that tie. I think you can say this. Capital is fungible. Iraq, because of the costs of prosecuting the war with Iran was short of capital. To the extent that we made credit available through the GSM 102 and 103 programs, that would not have been available without our loan guarantees, we increased the amount of available capital Iraq had.

To the extent our export programs permitted them to buy agricultural exports with credit in the United States, it freed up other capital that they had for prosecuting the war with Iran and purchasing necessary war material.

I think the argument that can logically be made and sustained certainly is that because capital is fungible, it is an inescapable conclusion that the fact that we provided capital to Iraq through this program did enable them to prosecute the war and feed their people in a way they could not have done without these loans.

Mr. BARNARD. Other than it being a possibility, do you have any direct evidence that that was done?

Mr. MENDELOWITZ. In terms of the money directly going for this purpose, we don't have any evidence on that. We have not seen it.

Mr. BARNARD. My time has expired, Mr. Chairman.

The CHAIRMAN. The gentleman is touching on a pretty important aspect here. I ask unanimous consent that we allow him have a minute so that I can conclude a point here.

Iraq insisted on bilateral deals. That was in violation of the United States policy in accordance with the Paris Club arrangement. So there had to be a foreign policy determination question.

Now, awhile ago, Mr. Dickerson, you expressed ignorance of the fact that the Export-Import Bank in 1987 and 1986 had not even been paid by Iraq. I think it is obvious here that Mr. Barnard's question is readily concluded to be answered definitely that there

was more than just a purely agricultural policy decision involved and the United States actually contradicted its own policy as a result of the Paris Club agreement in allowing bilateral arrangements with Iraq, which Iraq insisted on.

Iraq did not want to work within a whole international arrangement. So I wanted to make that point.

Mr. Leach.

Mr. LEACH. At the risk of some exaggeration, perhaps a lot of it, I would like to summarize the testimony the committee has heard. It appears that a country that should have been red-lined was provided greenbacks to buy foreign goods. That only applies to some of these circumstances. It is a very serious circumstance. It underscores what appears to be programmatic oversight problems as well as banking oversight problems.

My first question relates to something the gentleman from Georgia raised. In agriculture there are agricultural commodities. There are also agricultural chemicals that sometimes get sold between countries. Is there any evidence of any nature that this bank lender provided resources to buy chemicals that might have been used for nonagricultural purposes, Mr. Wiley?

Mr. WILEY. No.

Mr. CHARAMELLA. Mr. Leach, of the total amount of support we granted in Iraq, \$267 million, \$7.5 million related to agricultural chemicals. Some of those were supported by BNL in Atlanta, the herbicides, pesticides, Dursban and Lursban, which by our analysis suggested these were commonplace pesticides and herbicides that could be purchased off the shelf in any hardware store throughout the world.

We were satisfied that the chemicals, if you will, that we were supporting were not to be used for military purposes.

Mr. LEACH. Mr. Mendelowitz, do you have the same experience?

Mr. MENDELOWITZ. There is an investigation that is ongoing. I think that generally speaking, the position of the investigators is that this information should not be discussed to the extent it might adversely affect the ability to prosecute.

Mr. LEACH. You leave a rather wide open question at the end which raises a matter of concern. There were internal security problems as well as external war problems in the country during this time period. The human rights implications of the internal security problems are rather great.

There are only two other questions which I think are important at this time. One relates to a program in which one bank played a very concentrated role. Second, that program was disproportionately concentrated within one single country. That implies a problem for the agricultural department and their regulations as well as for banking regulators.

Mr. Dickerson, were there ever any discussions between the banking department and banking regulators on potential problems in this area?

Mr. DICKERSON. No. Let me point out, if I may, that BNL was not the only participant relative to Iraq and a number of other countries as well.

As I pointed out, the current potential liability on the part of CCC is roughly \$2 billion. BNL has a portion of that. There were a

number of other banks. BNL participated in taking letters of credit for banks in other countries, primarily North Africa. Their involvement was not disproportionately related to the amount of CCC is potentially now liable for.

Mr. LEACH. Mr. Mendelowitz, you use a very careful phrase in your statement when you talk about "only a fraction of these loans were authorized by higher level authorities in the bank." Authorization and knowledge are two different kinds of circumstances.

Do you think higher level authorities had knowledge of these loans and they just didn't authorize them.

Mr. MENDELOWITZ. I could not say at this point. The work is ongoing and I don't know.

Mr. LEACH. Is there any knowledge that the bank has violated any United States laws?

Mr. MENDELOWITZ. There is, as I said, an investigation being undertaken by a number of entities and it is ongoing.

Mr. LEACH. What are the remedies? There can be civil penalties but can there be banking regulatory restraints on the operation of the bank?

Mr. MENDELOWITZ. Yes. I don't really have it at my fingertips, the full range of possible disciplinary action. I believe that a later panel has representatives of the bank regulatory agencies and I think they will be better equipped to answer that than I am.

The CHAIRMAN. The Chair would say the next member to be recognized is Mr. Kennedy, however, Ms. Oakar has a time problem and she asks unanimous consent to be recognized first?

Mr. KENNEDY. Certainly.

Ms. OAKAR. Thank you, Mr. Chairman.

Mr. Chairman, let me ask about the Export-Import Bank. I am a big fan of the bank. Frankly, I don't think we should have the ceilings on it that we do. You mentioned that with respect to chemical exporting, that it was done under the auspices of these guarantees, but that you did not see that they could be used in chemical warfare.

Why would Iraq want these chemicals? They have varieties of chemical plants there. I don't know the difference in terms of chemicals used for warfare and some of the stronger pesticides. Is there a big difference?

Mr. CHARAMELLA. I am not an expert in this field, Representative Oakar. What I can suggest to you is that the products, the pesticides we supported, Lursban and Dursban, as we understand it, were used principally for termite eradication in the country.

We have input from our team of engineers at the Export-Import Bank that it would not only be very inefficient to break these chemicals down to a base compound, which would eventually be used in some other methodology, but it is also very costly.

The products were off-the-shelf items.

Ms. OAKAR. You checked that out?

Mr. CHARAMELLA. Yes. We checked out every transaction we supported in Iraq.

Ms. OAKAR. Is it against the law for the Export-Import Bank to finance defense articles?

Mr. CHARAMELLA. Yes, in "less developed countries".

Ms. OAKAR. Could you explain the process used by the Eximbank to insure that defense articles are not sold using Eximbank financing?

Mr. CHARAMELLA. Yes.

We have a system in the bank, when products are questionable in nature as to their application, we first check to ascertain whether those products require export licensing procedure through the Munitions Control Department of the Department of State.

When that is satisfied, we are then satisfied that the products we are financing will not be used in a military nature.

We also check the buyers, the purchasers of those products and try to ascertain through the U.S. embassies the specific use for those products and whether they have a military application.

So we have a number of things we do to prevent supporting the sale of military products.

Ms. OAKAR. There is a company in Solon, OH, not in my district, but nearby, where the Federal Government, our Government, closed it down because they suspected this particular company, Matrix Churchill, a subsidiary of a British-located company, was exporting weapons-making machinery to Iraq.

Was any Eximbank loan guarantee given to this company? Were they given assistance?

Mr. CHARAMELLA. Not to my knowledge.

Ms. OAKAR. Mr. Dickerson.

Mr. DICKERSON. Not to my knowledge.

Ms. OAKAR. GAO's study is very, very critical, Mr. Dickerson, of your operation, and it makes some recommendations.

Have you read the recommendations?

Mr. DICKERSON. Yes, I have.

Ms. OAKAR. What do you think of them? Do you think you might implement some of those recommendations?

Mr. DICKERSON. I think some of them are appropriate, Ms. Oakar.

As I mentioned earlier this morning, we have attempted to make changes that are appropriate in our program.

We have been doing so for the last year or year and a half.

Ms. OAKAR. Give me a specific change.

Mr. DICKERSON. For example, we implemented the process last November or last December which involves a price review of sales which are made under the GSM program to ascertain whether the sales prices received by the exporters are not in excess or in deviation with normal market prices one would construe for a particular commodity.

We have continued to remind exporters who are involved in these programs that they have a number of obligations in a regulatory way to the CCC such as maintaining documents and that upon call that we may access their records pertaining to CCC sales as well as all other commercial sales pertaining to any impropriety in the program.

There are a number of things which I just in part at least believe to be good suggestions and things that—any program can be improved.

I think we have made every effort over the last year to do just that.

The CHAIRMAN. The time of the gentlelady has expired.

Mr. Kennedy.

Mr. KENNEDY. Thank you, Mr. Chairman.

Mr. CHARAMELLA, I wonder if you could explain why did the Eximbank Board of Directors permit Iraq to use its programs after it was shown that Iraq had used poison gas on its own people.

I wonder about the advisory council, which consists of State, CIA, and other Departments.

Do they question whether these departments should be involved with countries that are in violation of the human rights policy?

Mr. CHARAMELLA. On the loan side, most transactions are processed through the National Advisory Council.

We do look to the human rights input from the State Department on those transactions.

With respect to the transactions in Iraq, we developed a very cautious attitude in the market.

Mr. KENNEDY. A caution attitude in the market?

Mr. CHARAMELLA. A caution attitude by establishing a \$200 million ceiling of exposure in the market for the short-term products primarily.

These were short-term insurance policies as opposed to loans. Never at any time did we provide loan assistance to the market.

We were merely providing a back-stop insurance to U.S. financial institutions that were supporting sales in the market.

Mr. KENNEDY. Were the amounts reduced after the chemical weapons were used by Iraq on its own people?

You say there is some sort of review process. I think everybody's common knowledge was that Iraq was poisoning its own people and all sorts of human rights violations were taking place.

Obviously it was a pretty flimsy review process in place, wouldn't you agree?

Mr. CHARAMELLA. I think the review process focused on the economic aspects.

Mr. KENNEDY. You mentioned there were 100 elements.

Mr. CHARAMELLA. For loans; correct.

Mr. KENNEDY. On the guarantees, there is no review process?

Mr. CHARAMELLA. Usually on guarantees and insurance for small transactions or amounts of this size, there is no review process.

Mr. KENNEDY. A couple hundred million dollars is a small transaction?

Mr. CHARAMELLA. There was a couple hundred million dollar facility, but that supported many different types of transactions.

Mr. KENNEDY. Two hundred million dollars is going essentially to one country. That is not a small amount of money.

Mr. CHARAMELLA. That is correct.

Mr. KENNEDY. I would think that the National Advisory Council ought to expand its purview into the guarantee portion of this at a bear minimum.

I noticed in your answer to Ms. Oakar's question that you indicated that you were not aware of this specific corporation, I can't recall the company she mentioned with regard to military sales.

Now I want Mr. Dickerson to answer this as well: Is there any knowledge or suspicion you have that the Eximbank was involved

in any way with military sales or equipment or guarantees of any kind?

Mr. CHARAMELLA. Absolutely not.

Mr. KENNEDY. Mr. Dickerson.

Mr. DICKERSON. The company was Churchill Matrix and no Exim guarantees have been issued to them.

No, I have knowledge about these guarantees covering anything but agricultural commodities.

Mr. KENNEDY. Including CCC?

Mr. DICKERSON. That is correct.

Mr. KENNEDY. Have you looked into that? Have you tried to find out what was going on?

Mr. CHARAMELLA. We have looked into it. We had a clearance procedure in place for every transaction in Iraq that identified the product and how it would be used in that country.

Mr. DICKERSON. When this transaction takes place, the bill of lading is cut and the exporter must provide documents which require proof that the agricultural commodities are part of the manifest.

Mr. KENNEDY. Mr. Dickerson, you said in your testimony that at one point, BNL held approximately \$760 million in receivables from Iraq, in which payment was guaranteed by CCC.

The Federal Reserve, BNL had a limit of only \$100 million. Thus, the approximately \$650 million of BNL's loans to Iraq were potentially unauthorized.

Given the fact that \$347 million that is owned to BNL is probably resulting from unauthorized loans, can the USDA avoid those loans being repaid to BNL?

Mr. DICKERSON. The guarantee is to the exporter. I have no knowledge of any way we would be able to walk away from that obligation.

Mr. KENNEDY. Had the exporter already been paid or not?

Mr. DICKERSON. Yes.

The guarantee is issued to the exporter and the exporter assigned it to the bank.

I don't see any interlock between the fact that they are over the limits self-imposed with our obligation to pay them the guarantee.

Mr. KENNEDY. May I have 20 more seconds?

The CHAIRMAN. No objection.

Mr. KENNEDY. If we have 200,000 troops on the border, it seems we are going to be tucking it to the Iraqis.

I don't see why we should not feel very comfortable in doing just that at the moment.

Is it to preserve your worldwide contacts? I don't know why we don't slam the door shut on them.

Our President is talking about going to war with these people and we are going to be guaranteeing money to them.

This is craziness, wouldn't you say?

Mr. DICKERSON. My response is that our legal obligations are assigned guarantees to exporters who have assigned them to U.S. financial institutions.

Your question is, should we walk away from these obligations to U.S. financial obligations.

Mr. KENNEDY. The loans are another question.

The CHAIRMAN. Mr. Kennedy, the guarantees are to the BNL. I think we need to understand that in all these arrangements, you have syndication with the loans so God only knows.

Mr. SCHUMER.

Mr. SCHUMER. Thank you, Mr. Chairman.

Mr. Wiley, I was interested in your statement. It seemed like apology for Iraq.

What do you think of Saddam Hussein?

The CHAIRMAN. Mr. Schumer, I don't know.

Mr. SCHUMER. Well, Mr. Chairman, I was surprised.

The CHAIRMAN. It is extraneous to this.

Mr. SCHUMER. I thought the whole statement was extraneous, too.

The CHAIRMAN. You can ask him about that.

If you feel his statement was contentiously sympathetic to Iraq, stick to that, but I think to ask him what he thinks of an individual, I think everybody has expressed themselves about that.

Mr. SCHUMER. Well, they are not here, Mr. Chairman.

When I read the statement, I was wondering if the same view was shared by the Iraq Business Council who seems to, at least in this statement, feel that it wanted to explain to us how Iraq felt and why they have to do the things they do.

You say no weapons were sold. there were three members of your group, Lockheed, Bell Helicopter, and General Motors. They never sold weapons.

Mr. WILEY. They never sold weapons. There were some dual-use items that were properly licensed after investigation.

Mr. DICKERSON. The investigation that took place at the time convinced the authorities and the Government that they were not for military purposes.

Mr. SCHUMER. The furnaces included?

My colleague from Georgia wanted me to ask about that. I will yield to him.

Mr. BARNARD. There was an authorization for furnaces to be shipped from a New Jersey company to Iraq.

Only at the last minute, I think, were they canceled. It determined that those furnaces could be used to make nuclear power.

Mr. WILEY. And the shipments were canceled, as I understand it.

Mr. BARNARD. Only at the last minute, no.

Mr. WILEY. They did not clear the process so they were not shipped.

Mr. SCHUMER. Mr. Dickerson, what concerns did your Department have about Iraqi's record of terrorism, human rights violations particularly after Iraq used chemical weapons on the Kurds.

Did that change your policy in any way?

Mr. DICKERSON. The administration of the program, as far as Iraq is concerned, with my limited history of 14 or 15 months, did not include any consideration of human rights.

It was a market-driven, agricultural-related program without reference to the other issues.

Mr. SCHUMER. So it would not have matters they gassed ten times as many people, you would have kept pushing exports.

Mr. DICKERSON. I didn't say that.

I said my responsibility and those of my colleagues in the program are concerned about the agricultural aspects of it and the risk analysis.

The things you describe would be in the purview of those who come to the NAC and of the White House.

Mr. SCHUMER. If no one from the White House or State Department came to you and said, "Stop pushing these sales," you could continue to push them?

Mr. DICKERSON. The program is not designed that way and it would not have happened.

Mr. SCHUMER. GAO state repeatedly people in the Agriculture Department as well as the State Department not only approved these sales, but went out and tried to actively recruit foreign governments and others to buy them; correct?

Mr. DICKERSON. It is my understanding that prior to coming to FAS that Congress and the United States considered sanctions against Iraq a number of years ago and decided not to go ahead and implement those sanctions.

Mr. SCHUMER. It should be asked of Congress. I had an amendment 2 months before Saddam Hussein invaded Kuwait to cut off these sales and it lost in Congress, too.

I am asking your view, what your agency did. You would continue to actively solicit sales under this program?

Mr. DICKERSON. No, I would not recommend that.

Mr. SCHUMER. Let me make it clear. Regardless of the human rights and other kinds of activities, unless the State Department or the White House put a red light on it, that is my question?

Mr. DICKERSON. That is correct.

Mr. SCHUMER. Thank you.

GAO, let me ask you: FAS believes it should be their role to monitor financial institutions. They don't believe it should be.

Let me rephrase that. FAS does not believe it should be their role to monitor or oversee financial institutions in the Export Credit program. They say the primary regulators have this function.

Do you agree?

Mr. MENDELOWITZ. Do I agree that that is their position, Mr. Schumer?

Mr. SCHUMER. No, do you agree that is what the law calls for and that that is what the law ought to call for?

Mr. MENDELOWITZ. The FAS position with respect to GSM-102 and 103 is that normal commercial disciplines assure that the program will operate efficiently. We do not necessarily believe that is the case.

In our investigation we came up with less than arm's length relationships between banks in this country receiving the guarantees and the countries whose commodity purchases were guaranteed by GSM-102 and 103.

An internal control improvement we recommended that has not been implemented is that FAS on a random check basis ascertain that the commodities that are supposed to be shipped under the program are in fact shipped and arrive at the intended destination.

Currently, as long as the paper trail appears in order and nobody files a claim for reimbursement, there is no way FAS would look

into a shipment. That is one of the internal control weaknesses in the program. What can happen as the program is currently constituted, we could give a loan guarantee to Iraq, or we could have before the invasion of Kuwait, a commodity could be exported and diverted on the high seas to another country.

Iraq could use the money for whatever they choose and so long as they continued to service the guaranteed loans, nobody would be the wiser.

Mr. SCHUMER. Your work in this area has been superb and ground breaking. FAS has implemented some of your recommendations and they have been slow to implement others. Have you asked them why they have not implemented all of them given the sorry record that they have and are their answers very satisfying to you?

Mr. MENDELOWITZ. As I said earlier, we really perceive a substantial change in the attitude of FAS over the past year. When we first pointed out the program problems to FAS management in 1987 and 1988, the Administrator totally rejected the criticisms we were making. As the problems became more publicly visible, FAS backed off of their rejection. Then with the new administration and new leadership coming into FAS, they have been I think much more receptive to the management and internal control recommendations we have been making.

One of the reasons they gave us for not implementing some of our recommendations is that they report that they don't have the staff to actually go out and inspect at the ports and do the things that we are recommending. Certainly, there is some legitimacy to that position and maybe an appropriate response would be to see that they receive the necessary allocation of resources so that they can more fully manage these programs and institute what we think would be a full and complete set of internal controls.

Mr. SCHUMER. One final question, Mr. Chairman, to Mr. Dickerson. In retrospect on either a financial basis or whatever, moral or ethical basis, do you think that FAS went overboard in sales to Iraq?

Mr. DICKERSON. I think it is easy at this point to say it was a mistake to have these credits for Iraq because we are facing a \$2 billion liability. That goes without saying. Up until the invasion of Kuwait, Iraq was servicing debt on a regular basis, they were one of the best performers in our portfolio.

So at this point in time we have to say it was a mistake.

The CHAIRMAN. The time has expired.

Mr. SCHUMER. I ask unanimous consent for 30 seconds to finish that.

The CHAIRMAN. Hearing no objection, it is so ordered.

Mr. SCHUMER. How about on an ethical basis, should FAS sell to anyone who will have a good prepayment record no matter what is going on in their country? What is your personal view?

Mr. DICKERSON. My personal view is that this is for the interagency council to decide. FAS develops these programs and takes them to the NAC with our recommendations. I might respond to the foreign policy aspects.

The interagency process does not see this is protection programs until Agriculture brings them to their attention. Yes, I have my

own personal individual moral concerns about Iraq and other destinations but I see USDA role as developing these programs and bringing them to the interagency process for consideration.

The CHAIRMAN. At this point every member of the committee will have the right and prerogative to submit questions in writing to the witnesses.

We thank you very much for your cooperation and the time you have given us. I will have questions I will submit in writing to you. Well, we have to cut off somewhere. We have a rule that Members coming in 2 hours after the beginning of the hearings will not question. So every Member will have the right to submit question in writing.

Thank you, very much, gentlemen.

Mr. H. Terry Smith, Senior Vice-President, Supervision and Regulation, Federal Reserve Bank of Atlanta. Mr. John B. Kline, CFE, Deputy Commissioner for Supervision, State of Georgia, Department of Banking and Finance. Mr. Pietro Lombardi, Regional Manager, U.S. Operations, BNL, New York, New York. Mr. William Taylor, Staff Director, Division of Banking Supervision and Regulation, Federal Reserve Board of Governors.

Thank you, gentlemen. We thank you for your written statements. Those will be in the record exactly as you presented them to us with any other documents that you have attached. Because of the lateness of the hour the Chair will suggest that if it is possible to summarize and be succinct we would appreciate it.

If there is no problem with some of the witnesses who might have time constraints, we will recognize you in the order that we have introduced you. And we will recognize Mr. Smith.

STATEMENT OF H. TERRY SMITH, SENIOR VICE-PRESIDENT, SUPERVISION AND REGULATION, FEDERAL RESERVE BANK OF ATLANTA

Mr. SMITH. Thank you, Mr. Chairman. I will summarize my statement. Mr. Chairman and members of the Banking Committee, I appreciate the opportunity to appear today and discuss the events of the Federal Reserve Bank in Atlanta.

First, I will briefly describe the Federal Reserve's role in supervision of foreign banks in the United States and, with that background, describe the supervision of BNL-Atlanta. Second, I will discuss how we learned of irregularities at BNL-Atlanta and discuss the results of our examination of that office shortly thereafter. Third, I will discuss what has transpired since the examination.

The passage of the International Banking Act of 1978 established a framework for Federal supervision and regulation of foreign banking organizations operating in the United States. The Act left primary examination authority with the licensing entities, the States and the Office of the Comptroller of the Currency, but it gave oversight responsibility to the Federal Reserve System. This responsibility included residual examination authority, but the Act specified that the examination efforts of the primary regulator were to be relied upon whenever possible.

Within this framework, the Federal Reserve Bank of Atlanta has discharged its responsibilities by assuring that each agency re-

ceives timely examinations from its licensing authority. Our program for international supervision has been increased as the financial health of our constituency has changed. Thus, in 1988, we began an enhanced examination program and focused our resources on Florida agencies of relatively weaker parent banks.

In the State of Georgia, our participation in examinations has been limited to a review of reports submitted to the Federal Reserve, a check of compliance with Federal banking laws and, on occasion, assisting State examiners in reviewing outstanding loans. Since the irregularities were discovered at BNL-Atlanta, and as resources have become available, our program in Georgia has been expanded to an informal alternate year examination schedule, in which the Atlanta Reserve Bank and the State of Georgia divide the examinations of agencies during a calendar year.

BNL-Atlanta opened for business as an agency on May 19, 1982. The office had been examined annually since 1983 by the State of Georgia, with limited assistance by the Federal Reserve Bank of Atlanta as I just described.

The Atlanta Reserve Bank became aware of the possibility of concealed transactions at BNL-Atlanta on July 28, 1989, when contacted by the U.S. Attorney's office in Atlanta. We immediately informed officials of the Board of Governors in Washington and officials at the Federal Reserve Bank of New York. Coordination began immediately within the Federal Reserve System to determine the proper course of action.

One week after becoming aware of possible irregularities at BNL-Atlanta, on August 4, 1989, a coordinated surprise examination of all BNL offices in the United States commenced. This effort involved the Federal Reserve Board and examiners from the Reserve Banks in Atlanta, Chicago, New York, and San Francisco, who examined BNL offices in Atlanta and Miami, Chicago, New York and Los Angeles. Also on that date senior officials of the Board of Governors and the New York Reserve Bank met with BNL management in Rome to inform them of the problems in the Atlanta agency. The Bank of Italy was alerted also.

Our examination confirmed the existence of concealed transactions at BNL-Atlanta. BNL-Atlanta had failed to report \$1 billion in outstanding loans to the Central Bank of Iraq, \$800 million in outstanding loans to Rafidain Bank of Iraq, \$1.2 billion in commitments to lend to the Central Bank of Iraq and \$1.8 billion in liabilities borrowed to fund the concealed lending.

Since the commencement of our surprise examination, much has occurred to correct the problems of the agency. A new management team was in place on the day following the start of our examination. A number of BNL Atlanta officers and employees were dismissed. BNL-Atlanta's money market operation was closed, and its letter of credit operation was placed under the close, on-site scrutiny of officials from BNL-Rome and BNL-New York who came to Atlanta.

The books of the Atlanta agency have to a large extent been reconstructed, and the office has received a qualified opinion on its financial statements from outside accountants.

The Atlanta Reserve Bank continues to extend considerable resources to act as technical advisors to the various U.S. agencies interested in BNL-Atlanta.

In summary, Mr. Chairman, after we were informed by the U.S. Attorney of possible irregularities at BNL Atlanta, the Federal Reserve moved quickly to identify and contain the problem. Only 1 week after disclosure of the irregularities, simultaneous surprise examinations were commenced at each office of BNL in the United States, coordinated among the four Reserve Banks and the Board of Governors.

Senior officials from the Federal Reserve Bank of New York and the Board of Governors were in Rome to personally inform BNL and the Bank of Italy. The problem was contained and new management installed. Since the events of August 4, 1989, support has been extended to various agencies of the United States to provide technical assistance for their investigations.

I am very pleased to appear today and to provide this information. That concludes my remarks, Mr. Chairman. I will be happy to answer questions.

[The prepared statement of Mr. Smith can be found in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Smith.
Mr. Kline.

STATEMENT OF JOHN B. KLINE, DEPUTY COMMISSIONER FOR SUPERVISION, DEPARTMENT OF BANKING AND FINANCE

Mr. KLINE. Thank you, Mr. Chairman.

I have submitted written comments, and I will just summarize those for you, plus some additional points that have come up since this process began.

It's a pleasure to be here before you, Mr. Chairman, and distinguished Members of the committee; and I hope we can provide the assistance that you need in carrying out your responsibilities.

As has been mentioned earlier, this matter has been widely reported but is under active investigation by the United States Attorney's Office. And we have been advised to avoid specific discussion of activities due to the Grand Jury process.

Also, there may be certain criminal liabilities under Georgia laws which would come into play as well.

Throughout this process, as Mr. Smith indicated, we have cooperated with the other regulatory agencies in the examination process that was conducted when these transactions became involved and also with the investigating agencies to the extent that we have been allowed to participate.

In our written comments, we do explain that the license of BNL Atlanta agency is licensed by the State of Georgia, the Department of Banking. It's an annual license that can be asked to be renewed every year, and that is the tool, if you will, that is available throughout this process, the possibility of revoking that license. That is the repercussions that could take place when the investigations are completely finished.

The purpose of the foreign agency as it was enacted in Georgia law was to bring capital and investment to Georgia and to the

Southeast, and that is why we have foreign agencies operating within the United States and specifically in the State of Georgia.

We examine our international bank agencies annually, as we examine all of our banks and bank holding companies in Georgia. The fundamental cause in our opinion of the events that are being discussed today was a breakdown in the basic ingredient of any security system, which is dual control.

There was significant collusion and a highly sophisticated scheme that was carried out to conceal illegal activities which were successful, to a point.

This is frequently true when perpetrators have the ability to direct their full attention to the concealment and auditors have a limited amount of time and resources to devote towards detection of these types of problems.

Pursuit of audit exceptions and the unwieldy size and complexity of the scheme are thought to be the reasons why this matter finally surfaced. The network of internal control, internal audit, external audit and regulatory overview ultimately caused the irregularities to be revealed, despite extraordinary efforts to conceal them.

The question has been raised that the regulatory structure governing U.S. branches and agencies is inadequate. The State of Georgia rejects the premise that the BNL Atlanta case was the result of any regulatory breakdown. The regulatory structure was never designed to be a front line for fraud detection.

We had in place a network that was activated as soon as we became aware of the activities, and we coordinated with the Federal Reserve and through the Federal system to make appropriate members of the other regulatory agencies aware of the activities.

Certain cross jurisdictional problems did occur during the investigation. It could be addressed using the experiences gained from this process. However, it's not our belief that legislative action is necessary to accomplish this.

Mr. Chairman, there are several other points that I would like to make that have come up. Number one is that the bank regulatory agencies don't have responsibility or authority to monitor United States foreign policy. Our responsibility is to monitor the safety and soundness of the financial institutions.

In response to the charge that there was no follow up on the BNL audit exceptions, we require an internal audit as well as an external CPA audit. We had an external CPA audit by a Big Eight accounting firm done as of December 31, 1988.

That audit report, certified audit report was received in March of 1989 prior to the State Banking Department sending out its examination report. And that external audit report gave them a clean bill of health.

We relied on the external CPA audit report. The country of Iraq was not on a prohibited country list. It—Iraq—was not on a list of countries that a bank cannot do business with; not any list that we had knowledge of at that time.

A lot of the discussions that have taken place today are dealing with events that took place since August of this year, whereas these events took place in 1988 and 1989. A charge has also been made that we never received a copy of the internal audit of BNL.

And let me assure you that we did receive a copy of that internal audit, and we are aware of what was revealed in that audit.

We did not receive it prior to the completion of our examination in February of 1989, however. But we do have a copy of that and are aware of that. We also had a copy of that external audit, as I referred to.

In summary, I want to make these points. The agency did not accept Federally insured deposits; no depositors of the United States lost any money. No creditors of BNL, to our knowledge at this point in time, lost any money. These are our supervisory responsibilities, to look after the depositors and creditors of the institutions.

The parent bank——

The CHAIRMAN. Let's stop right there, Mr. Kline. The very nature of this agency is it doesn't accept deposits like an ordinary bank, so that is self-evident. I mean, you are not going to——

Mr. KLINE. So, they do take certain types of deposits. We don't take insured deposits, but our responsibility is to look after any depositor, whether it be an insured depositor, whether a Federal insurance, or a liability held.

And that is what the statutes in Georgia law state that our responsibility is. And neither of those entities have lost any money. The parent bank has not been rendered insolvent as a result of this, and that is the other aspect that we are to look at.

The apparent criminal violations that came to our knowledge were reported to the appropriate judicial authorities, and that was the other aspect that the State Banking Department had responsibility to do, to report apparent criminal violations.

Mr. Chairman, I think that you will find——

The CHAIRMAN. Yes.

Mr. BARNARD. Do you intend to let us vote?

The CHAIRMAN. Yes, sir.

We will stand in recess for about 10 minutes.

[Recess]

The CHAIRMAN. The committee will come to order.

Our next witness, Mr. Lombardi.

STATEMENT OF PIETRO LOMBARDI, EXECUTIVE VICE PRESIDENT AND REGIONAL MANAGER FOR NORTH AMERICA, BANCA NAZIONALE DEL LAVORO (BNL)

Mr. LOMBARDI. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, my name is Pietro Lombardi, and I am an Executive Vice President and Regional Manager for North America of Banca Nazionale del Lavoro, BNL. At your request, I am here to respond to the questions raised in the chairman's letter to me dated September 25, 1990.

At the outset, I should note that I was transferred from the Rome headquarters to the regional headquarters of BNL in New York shortly before the so-called "Atlanta affair" was uncovered in August 1989 and that my personal knowledge of this matter is largely based on what I have been told since that time by others who are involved in investigating the affair, not by those who were directly involved in what happened.

As you know, these transactions are still being investigated by the Departments of Justice and Agriculture and several regulatory agencies both State and Federal. In addition, a Federal Grand Jury was convened in Georgia in August, 1989 to investigate this matter.

The Justice Department has notified BNL that it is not a target of that investigation. BNL has been actively cooperating with all of these investigations. Moreover, BNL has filed a civil lawsuit in Federal district court in Georgia against two former officers of the Atlanta agency in connection with these transactions (*Banca Nazionale del Lavoro v. Christopher Drogoul and Paul Von Wedel*).

Due to the criminal investigations, however, all discovery in that lawsuit has been stayed by the Federal court. BNL does not want to make any statement or take any action which would prejudice these legal proceedings or impair the prospects of having the responsible persons brought to justice.

By way of background, BNL is the largest commercial bank in Italy in terms of deposits. As of December 31, 1989, the Italian Ministry of the Treasury and other entities controlled by the Italian government owned approximately 96 percent of BNL's shares. BNL operates in the United States through its offices in New York, Chicago, Los Angeles, Miami, and Atlanta.

Turning to the questions you have raised, I know that your staff in a public hearing has summarized the general scheme that was used by former employees of the Atlanta agency to victimize the bank. In addition, of course, the complaint filed by BNL in connection with the lawsuit in Federal court referred to above has been submitted to the committee's staff, and I ask that it be included as part of my testimony.

The CHAIRMAN. Without objection, so ordered.

[The information referred to can be found in the appendix.]

Mr. LOMBARDI. On August 4, 1989, BNL representatives in Rome and New York were informed by various agencies of the U.S. Government that BNL's Atlanta agency had provided various types of unauthorized financing—unauthorized by BNL but not in contravention of U.S. law or policy—to Iraqi Government entities.

This news stunned BNL, because of the amounts involved and the uncertainty of the consequences. In order to have successfully hidden these transactions from BNL and the regulators, several persons in the Atlanta agency must have been involved. In order to discover the true size and nature of these transactions, a comprehensive attempt to reconstruct them was undertaken by BNL.

In general, these unauthorized transactions—unauthorized by BNL but not illegal or in any way inconsistent with the policy of the United States—consisted principally of, one, extending credit facilities to certain Iraq government entities and other private entities in Iraq, and two, participating in the Agriculture Department's Commodity Credit Corporation (CCC) programs with respect to Iraq and other countries in excess of levels approved by BNL.

Insofar as Point One is concerned, neither the U.S. Government or the U.S. banking system has lost or will lose any money as a result of these transactions. Moreover, no American has lost or will lose any money as a result of these transactions.

Neither BNL's Atlanta agency or any other U.S. office of BNL is insured by the U.S. Government. Accordingly, the Federal Deposit

Insurance Corporation will not incur any liability for any of these transactions.

Liabilities in connection with these transactions have been assumed by BNL in Rome. Although at this time BNL is at risk, the extent of the loss is still unclear.

The basic point to be made is that BNL was the victim of the actions of the former officers and employees in Atlanta. We believe that these individuals acted on their own to make these unauthorized transactions and then engaged in clandestine efforts to deceive BNL and others about their existence.

As a result, BNL's reputation has suffered, and it is at risk on the money owed to it by Iraq. Thus, although these credits were made through the Atlanta agency without BNL's approval, they are now considered to be loans extended by BNL in Rome for which BNL is obligated.

I would now like to turn to Point Two, that is the CCC loans. Insofar as the CCC loans are concerned, although these loans exceeded internal limits sanctioned by BNL, they were not illegal or contrary to U.S. law or policy towards Iraq in effect at the time.

In particular, the Atlanta agency's participation in the CCC programs was in accordance with CCC rules and regulations with respect to all of the countries involved, including Iraq. In fact, the U.S. Government authorized these programs for the benefit of American farmers and exporters of agricultural commodities and intended that financial institutions would participate in them.

In this regard, I would also like to note that several other financial institutions in the United States participated in the CCC programs for Iraq. The record shows, for example, that major American banks participated in these programs. Further, for the current \$2 billion of authorized CCC guarantees involving Iraq, BNL holds only \$382 million (less than 20 percent of the total).

Thus, although the Atlanta agency exceeded internal limits for participating in the CCC programs, its participation was legal and entirely consistent with the policy of the CCC which prevailed at the time. BNL's participation did not increase or affect the amount of approved CCC exposure. In fact, the CCC programs for Iraq continued after August, 1989 through the participation of other banks.

During the period in question, BNL's Atlanta agency was subject to regular and customary annual examinations by the Federal Reserve Bank of Atlanta and the Georgia Department of Banking and Finance. The external auditors, Peat Marwick, also conducted annual audits and examinations.

The BNL system of internal controls in effect prior to August, 1989 only detected operational problems and did not anticipate the extraordinary circumstances and activities that occurred in the Atlanta agency.

In spite of internal and external controls, however, the responsible individuals in the Atlanta agency were able to avoid detection. This, of course, is regrettable. No one regrets this more than BNL because it is the victim of the deception and will lose money from it.

BNL has since implemented a wide variety of actions to protect against a reoccurrence of such misconduct. While we are continuing to work with the bank regulators on this subject, the new con-

trols and procedures include a more rigorous audit program, concentrating funding and foreign exchange operations in the New York branch, which is now the BNL treasury center for the United States; instituting stricter credit limits; requiring all BNL offices to use the same computer system in order to permit constant regional management supervision; and rotating experienced BNL employees through each BNL office.

We believe, Mr. President, that these new controls will effectively guard against such misconduct in the future.

In this regard, I should also note that since BNL was made aware of this matter, it has devoted significant resources and personnel to the matter. Also, BNL has cooperated fully with all of the U.S. and Italian investigations, and it continues to do so.

In response to one of your questions, Mr. Chairman, BNL has not been asked by the Federal Reserve or any other bank regulatory agency to sign a supervisory agreement in this regard.

In Italy, the Atlanta affair has been the subject of a number of investigations. The Bank of Italy, which monitors BNL's activities, has examined this affair. I also understand that an Italian Magistrate in Rome is conducting an investigation regarding possible criminal proceedings. In addition, the Italian Senate has appointed a commission of inquiry to investigate the matter.

Since BNL is owned by the Italian government, this matter and its economic consequences, as you can appreciate, continue to be of significant concern to the Italian government. Italy and BNL are, of course, abiding by the economic sanctions imposed against Iraq.

Regarding the question in the chairman's letter addressed to me about whether the regulatory structure governing the activities of foreign banks in the United States was responsible for this affair, let me say that we believe that the Atlanta affair was due primarily to the collective efforts of a group of former employees who circumvented existing internal controls and procedures which in retrospect were inadequate to deal with the unique circumstances that existed in this case.

After all the facts are fully developed by the investigations underway, a more complete picture on questions of responsibility will emerge.

Let me conclude by saying that neither the American Government or any individual American has lost or will lose any money as a result of what happened at the Atlanta agency of BNL. BNL is the victim of what happened at its Atlanta agency. So, Mr. Chairman, as the victim of this whole affair, we support the work of this committee, and we will continue to cooperate fully with the American authorities.

Thank you for your consideration.

[The prepared statement of Mr. Lombardi can be found in the appendix.]

The CHAIRMAN. Thank you, Mr. Lombardi.

Mr. Taylor.

**STATEMENT OF WILLIAM TAYLOR, STAFF DIRECTOR, DIVISION
OF BANKING SUPERVISION AND REGULATION, BOARD OF GOV-
ERNORS OF THE FEDERAL RESERVE SYSTEM**

Mr. TAYLOR. Thank you, Mr. Chairman.

Per your request, I will abbreviate my abbreviated comments.

Mr. Smith, from the Federal Reserve Bank of Atlanta, I think, corresponded my first two points very well, that being the structure of relation and supervision of foreign branches and agencies in the United States, and the manner in which we at the Federal Reserve carry out our responsibilities under that structure.

What I would like to focus on are the final two points of my remarks which is basically how the authority was used in the case of Banca Nazionale del Lavoro, and what changes in supervisory methods and authorities are indicated as a result of the BNL case.

Our authority and responsibilities were exercised in the BNL case prior to the discovery of the fraud in Atlanta by actually conducting joint examinations or independent exams in States such as California and Florida and by accepting the State exams in such places as New York and by assigning an examiner to the Georgia State examination for the purpose of checking the agency's conformance with certain Federal laws.

Subsequent to the discovery of the fraud, we used our authority to do the following: One, we immediately began the simultaneous examination of the other offices of the bank to see if the fraud had spread further. We determined it had not.

We immediately contacted the Italian authorities to see that BNL was prepared and capable of meeting its liabilities in an orderly manner.

In addition, we sought immediate corrective action by BNL of the situation in Atlanta. I must say that our colleagues at the Bank of Italy responded immediately and effectively and that no depositor has lost money, no Federal Reserve borrowing were required,

BNL acted, I think, quite promptly by replacing the management and instituting controls that would hopefully prevent this type of thing from happening in the future. And finally, a comprehensive review by Italian authorities and ourselves in the State of Georgia have been initiated and continue.

As to the nature of the fraud itself, we continue to be concerned as this type of activity, the keeping of a double book, is very difficult to detect, especially the involvement of some people in the Atlanta operation.

Finally, and very importantly, we provided and continue to provide assistance and substantial resources to the U.S. Attorney in Atlanta as she seeks to assure that the perpetrators of this fraud are prosecuted.

Finally, what changes in authorities and practices might be considered? Although we feel we have enough authority under present law, we do think that the criminal provisions relating to banks such as bank fraud should be extended to cover State licensed uninsured agencies of foreign banks. At present, it's our opinion that they do not.

We have supplied legislation and hope the Congress will consider its enactment. As to the change in supervisory procedures, I would offer the following: Although it's our view that this type of fraud on the part of a large number of individuals is difficult to detect and that measures to guard against such fraud in the future cannot be made foolproof, we are deeply concerned that every effort be made at the Federal and State level to improve the capacity to uncover fraud of this nature.

In this regard, the Federal Reserve has recently and will continue to allocate more resources to on-site examinations of branches and agencies. We might also, Mr. Chairman, give reconsideration to our original proposal to the Congress in 1974, that proposal being that any foreign bank seeking or maintaining a State licensed branch or agency shall be required to make that branch or agency a State member bank and subject to the direct supervision of the Federal Reserve.

In closing, Mr. Chairman, I would like to add that the question, if we didn't catch this, we want to know why not. If the State didn't catch it, we want to know why not. If the outside auditor didn't catch it, we want to know why not? If BNL didn't catch it, I think they want to know why not, and I think it's very important that we focus our efforts on this point forward on enhancing the capability of all parties involved to detect this type of fraud and abuse.

We have had it happen before back in the 1950's and the 1960's. We have had various occasion where people basically just kept a double book. Procedures have been put in place that have discouraged it, and I think we can hold the hope that we can do the same here.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Taylor can be found in the appendix.]

The CHAIRMAN. Thank you.

We have another recorded vote.

What is this? I don't know why we would. We should be able to have a period of time that would allow us to complete the hearings.

But we will go to the House floor and record a vote and recess for about 10 minutes.

[Recess]

The CHAIRMAN. The committee will come to order, please.

Thank you again, gentlemen.

I wanted to thank you, Mr. Taylor. You have been very responsive. You have even gone to our field hearings in Texas and other places, so we are very grateful to you.

In your statement, Mr. Smith, on page 9, you say computer records of the Iraqi transactions were maintained on a separate system from BNL Atlanta's authorized operations. Hard copy records of concealed transactions were maintained in boxes and moved back and forth from employees' homes and cars to the office as needed. Employees would remove all boxes and computer records from the office before audits and examinations.

The majority of the work on the transactions, particularly funding operations, was conducted from employees' homes. These transactions were not included in reports filed with the Federal Reserve.

Now, couldn't this be going on in any of the other 531 or so institutions? What is to prevent it, as far as I see it?

Mr. SMITH. Mr. Chairman, I surely hope it's not occurring in any of the 500—

The CHAIRMAN. Yes, but that is what worries me. We have to go on more than hope.

We are talking about hardheaded financial transactions that have everything to do with the safety and soundness of our banking system, notwithstanding some of this wishful thinking that as long as the State citizens are not involved in risk, the facts, I think, ultimately will show that that is kind of risky.

We have more than that kind of a selfish and parochial responsibility. We have a national responsibility of awesome proportions. For instance, the State official here, Mr. Kline, talked about external audits. Well, my gosh, we have just gone through the terrible ordeal of the S&L debacle, and we know what external audits have meant. They have meant little or nothing.

On the other hand, we see here, and there is no evidence presented to the contrary, that the regulatory system is still a hodgepodge shot through and ripe with crevices and drop holes that this kind of practice cannot be guaranteed is not going on now among any of the other 531 or some similar institutions or identical institutions.

This is where I come from. This is the whole basis of what we are concerned about. I know that since this occurrence, particularly in the State of Georgia, for instance, the Federal Reserve Board has changed its examination schedule of agencies so that it now alternates examinations every other year with the State of Georgia instead of allowing the State of Georgia to do the entire examination as was the arrangement prior to the BNL affair.

So obviously, and somewhat belatedly, Federal Reserve has done that. But this is only because this case has become a sort of a news focus and dramatic scandalous example. I don't think that we can wait.

And the whole idea of these hearings is that we cannot avoid any longer, Mr. Taylor referred to past occurrences in the 1960's and 1970's. We are very mindful of that. And as a Member of this committee, all these near 30 years that I have been in the Congress, I agonized through that period, more than at any time in my whole career of the Congress.

Because we have the handwriting on the wall very clear. It was agonizing for me to see that the committee and the Congress generally wasn't really exerting its oversight responsibilities. We had the clear case of Continental Illinois. That, and what are we facing today to compound this matter? We are facing an entire crisis in our financial system, clear across the broad spectrum of our financial institutions, not just savings and loans.

It's been very distressing. We saw the clear signals. We saw the clear signs, and we saw the regulatory dysfunctions. We saw where a bank that just a year or two before was rated as the number one bank in the United States, maybe even in the world, suddenly was floundering, and the laws, the basic laws, the no more than 10 percent to one lender was violated flagrantly by the Continental Illi-

nois without apparently its chief officials being aware of that, nor the regulators.

We had the Pen Square corellary to the Continental. We saw where shockingly a shopping mall bank like Pen Square in Oklahoma could come in and exceed that limit willy-nilly, of regulatory authority, and itself create a chain reaction that led to the downfall of more than just a few institutions.

So at this point, we are trying to be as much preventive. It will be too late for us to have postmortems like this.

I said so when we had a belated hearing on the Pen Square, I said these are postmortem hearings. We are not going to do anything about the truths we have learned. And that is that the regulators, for whatever reason, and it can be justified, it can be justified like the gentleman in the previous panel from the Commodity Corporation said well, you know, we have our laws. We are faithful to them, and we are faithful to the Department of Agriculture.

In other words, that is a principle. We are carrying out orders. We cannot be responsible for an overall sense of accountability. So I would say that at this point, unless there is some rebuttal, we have no assurances that similar practices can be happening now even as we are gathered here today.

Mr. SMITH. May I comment?

The CHAIRMAN. Yes.

I welcome your comment.

Mr. SMITH. We recognize that there were potentialities in 1988. We selected, because of our constituency, the foreign agencies in the State of Florida because they were basically from Latin America which countries were experiencing financial difficulties.

We started a program at that time. We have extended or program to Georgia. So we are being proactive. We are taking steps. We are trying to learn from this situation.

The CHAIRMAN. Thank you very much.

Mr. Taylor.

Mr. TAYLOR. Mr. Chairman, I accept your remarks, and I would offer that the road to a solution really lies in more intensive and more frequent examinations whereby the level of management audit and audit of procedures and practices is augmented by finding out if it is there and if it is any good.

In other words, a direct verification and stipulation, if necessary, of spec audit procedures that are to be carried out so as to assure that is what is shown on the books is what is on the books, and hopefully an analysis of accounts carefully would lead one to have the capacity to understand if there were off-book transactions.

I think there have been corrections put in place by the Banca Nazionale del Lavoro, in the sense of making sure that the dual control features are reactivated, making sure that there is an auditor on site in Atlanta who does not respond and owe his life line to the management of that agency, and I think more intensive and ongoing supervision by Rome will also help.

Having said all that, it is, again, a very difficult practice, and these kind of procedures help, but there is no assurance that a double-book operation will be caught each and every time.

The CHAIRMAN. Thank you very much.

Mr. Wylie.

Mr. WYLIE. Thank you very much, Mr. Chairman.

Mr. Lombardi, on your statement in the concluding paragraph you repeated something that you had said a little earlier: "Let me conclude by saying that neither the American Government or any individual American has lost or will lose any money as a result of what happened at BNL."

It is my understanding that the CCC will eventually have to pay BNL \$347 million in loans; is that correct or not?

Mr. LOMBARDI. At this point, allow me to go back to what I mentioned in my statement.

The fact is that the liability of a CCC was not affected by BNL and what happened in BNL, because CCC provided for guarantees which were then assigned to some banks, but the guarantees issued to the exporter, the banks join in the picture later on. So it happened that when we performed this, we were in the same position as any other institution enjoying these kind of transactions, and as a matter of fact, what happened in Atlanta didn't increase the real CCC liabilities.

Mr. WYLIE. Well, are you telling me that BNL is going to absorb these losses and will not utilize the loan guarantees of the—

Mr. LOMBARDI. No. I am sorry. I am just saying that BNL joined in this program, which was fully authorized by the CCCF and Congress. Nothing that BNL did increased CCC's exposure under its program. In fact, one thing I think is important to stress is that those operations were legal according to the policy of the U.S., so we just joined these programs, as any other financial institution did.

But BNL in this case has not affected the CCC liabilities.

Mr. WYLIE. I am not sure I have understood the answer just yet. It would be fascinating if no individual American lost or will lose any money as a result of what happened in Atlanta. I like the sound of that, and I hope that proves to be the case.

Mr. Smith, BNL is the largest agency, bank agency, in Georgia, and in the Fifth District, which incorporates Florida. BNL is larger than most of the district's six agencies.

Was any special regulatory supervision provided for them?

Mr. SMITH. Not before August 4, 1989, Mr. Wylie, no.

Mr. WYLIE. Since?

Mr. SMITH. Since August 4, 1989, a lot of special attention has been provided.

Mr. WYLIE. In your opinion, could these unauthorized loans to Iraq have occurred without the knowledge of at least or tacit approval of bank's management in New York and Rome?

Mr. SMITH. Mr. Wylie, everybody that I have discussed this with has asked me that question, and to date we have no firm evidence of any conclusion by the New York office or the office in Rome, the head office in Rome.

Mr. WYLIE. Mr. Kline, when did you first become aware of the problems, and what steps did you take to try to avoid or prevent them?

Mr. KLINE. Mr. Wylie, we became aware of the problems in late July 1989 when we were contacted by the United States Attorney requesting some guidance as to how to proceed with the knowledge they had received about these alleged irregularities.

Subsequent to that, we were involved in the process with the Federal Reserve Bank in Atlanta that Mr. Smith had described, as were other State banking departments in the United States that had BNL offices.

Mr. WYLIE. What is the arrangement? I heard a little earlier that BNL takes deposits, but they are not insured.

Mr. KLINE. Yes, sir. Let me clarify that.

What I said was that BNL had deposits on its balance sheet. These are called credit balances or cash collateral deposits, and they represent deposits that came about as a result of a loan transaction. They don't accept commercial deposits or consumer deposits or anything like that, but the technical terminology for that, the accounting terminology is, it is called a deposit, but they—Georgia law only allows deposits that are incident to a credit transaction, and so that is the type of deposits they had, or essentially their own money that was held in reserve against loans or credits that had been extended.

Mr. WYLIE. OK. Thank you.

My time has expired.

The CHAIRMAN. Mr. Barnard.

Mr. BARNARD. Mr. Kline, I would like to know how many banks have failed in Georgia in the last 5 years?

Mr. KLINE. Zero.

Mr. BARNARD. How many have failed in Georgia in the last 8 years?

Mr. KLINE. Zero.

Mr. BARNARD. When was the last bank that failed in Georgia?

Mr. KLINE. The last bank that failed in Georgia was in March 1981, almost 10 years ago.

Mr. BARNARD. Mr. Chairman, I would solicit your attention to that particular testimony. As he just said, there has not been a bank failure in Georgia since 1981.

Mr. Smith, when was the last bank failure—how many banks have failed in the Sixth Federal Reserve District in the last year?

The CHAIRMAN. Will the gentleman yield?

Mr. BARNARD. Yes, sir.

The CHAIRMAN. We have the Commissioner of banking in New York and he said the same thing for New York, because they have a 7 percent capital requirement, hard core capital.

Mr. BARNARD. I think that is good. But the point I am making is that the scenario that has been painted here just a minute ago does not necessarily paint the picture I think that you are depicting. I mean, as a State like Georgia that has not had a bank failure since 1981, let me pursue my question.

Mr. Smith, when is the last bank failure you had in the Sixth Federal Reserve District?

Mr. SMITH. We had a bank in Florida that failed about 60 days ago.

Mr. BARNARD. How many banks have failed in the last 10 years?

Mr. SMITH. I don't have those numbers with me, but they have been a number.

Mr. BARNARD. Could it have been hundreds?

Mr. SMITH. I think it was about 16 in 1983, 16 in our district, yes.

Mr. BARNARD. Mr. Taylor, let's talk about State member banks that are members of the Federal Reserve Bank. What is the record of failures there?

Mr. TAYLOR. Mr. Chairman, I think to frame the answer correctly, one has to do it in proportion to the number of banks supervised. The Federal Reserve supervises approximately 1050 banks.

Mr. BARNARD. That is State member banks?

Mr. TAYLOR. Yes.

Mr. BARNARD. Which you have a responsibility to go in and examine?

Mr. TAYLOR. Yes, sir.

Mr. BARNARD. Is that just yourself or with States?

Mr. TAYLOR. We like to think we do all of our State member banks in cooperation and coordination with the States.

Mr. BARNARD. That is a simultaneous examination?

Mr. TAYLOR. Yes, it is either simultaneous or it is alternate, or there is some participation by one in the other's exam, so that we have a full exchange of information.

But the total assets of State member banks, total approximately \$540 billion, or thereabouts; 1050, about \$550 billion in assets, so that means we have approximately 8 percent of the total banks in the county by number, and there is approximately \$3 billion—\$3.6 trillion in total assets.

So we have a fairly small portion that would be somewhere around, I think, 16 or 17 percent of the assets.

Mr. BARNARD. How many banks have failed?

Mr. TAYLOR. It depends what period you pick, but last year there were, I think, 14 banks—or 10 banks have failed so far this year. Fourteen banks failed last year.

If you take the total failure rate, and I am very suspicious and not—I don't say these statistics—they can change at any point. But we have 8 percent of the banks and we have about 7 percent of the failures in number. We have about 16 percent of the banks in dollar of assets, and about 1 percent of the failure in assets.

Mr. BARNARD. One percent have failed?

Mr. TAYLOR. No, no. One percent of the—in other words, proportionally, compared to the assets we supervise, which are about 17 percent of the system, we have 1 percent—

Mr. BARNARD. I expected that from the Fed. I still don't know quite where you are coming from.

Mr. TAYLOR. I think what I am saying is that the record at least to date, whether it is 1 year or 5 years or 10 years or 20 years, is that the Federal Reserve has about the same proportion of failures as the other agencies by number and much less by dollar amount, dramatically less by dollar amount.

Mr. BARNARD. OK.

Going back to your statement in answer to Mr. Gonzalez, here was a situation, how could this situation have been determined by, number one, bank examination; number two, by independent audit, both of which evidently failed, and third, by internal audit? How could this situation have been determined before it did?

Mr. TAYLOR. Well, this is all after the fact, so it is much easier. Quite frankly, as I testified, it is very difficult to determine an off-book operation. Looking back at it, and without criticisms whatso-

ever, the point is that there was not audit separation at the Atlanta agency, and had there been a requirement by either the internal auditor or the external auditor of the Bank of Italy or ourselves or the State, requiring that there be an auditor on site that reported to headquarters the potential——

Mr. BARNARD. You are talking about an auditor hired by BNL?

Mr. TAYLOR. Yes.

Mr. BARNARD. What was the function of the independent auditor if he wasn't to do that?

Mr. TAYLOR. And, second, the independent auditor could have indicated that that should have been the case, that there should be a direct reporting of the finances of that agency to Rome, without having that individual responsible——

Mr. BARNARD. Do you think that that would have interrupted this operation?

Mr. TAYLOR. I think it would have helped the possibility of discovering it.

Mr. BARNARD. But wasn't it actually discovered, though, because of the fact is that there were some people involved, the internal audit was so aggressive that they got frightened, and there was somebody then spilled the beans? Wasn't that the scenario of how it happened?

Mr. TAYLOR. I have to be a bit cautious here, given there is a criminal investigation underway.

Mr. BARNARD. OK. I expect that.

Mr. TAYLOR. I wouldn't—I guess I would not speculate on that statement.

Mr. BARNARD. Mr. Chairman, I would just like to make one little editorial comment, that you are absolutely correct, Congress certainly did not take the sufficient cognizance of what was going on back from 1983 to 1988 or 1989 as far as ongoing hearings that were being conducted by committees of Congress.

And both you and Mr. Wylie, as well have joined me in legislation that was finally adopted into law, in Title IX of FIRREA, which finally gave the regulators enough really enforcement powers to do something about inside abuse authority.

And I think that Mr. Taylor, who has been around a long time, will indicate that until we put some of those enforcement powers in the FIRREA bill, that the regulators sometimes—I mean in that period of time, had their hands tied as far as prosecuting, discovering inside abusive fraud.

Am I wrong there?

Mr. TAYLOR. There are many portions of FIRREA that are a great help to us in doing our job. There is just no question of it.

Mr. BARNARD. And you didn't have them before FIRREA?

Mr. TAYLOR. And, again, I reiterate, I request that this question of making sure that the fraud part of the United States banking law, of United States law applies to uninsured branches, I think, is another tool that will help us.

Mr. BARNARD. Mr. Chairman, would you have me unanimous consent, one additional 30 seconds?

The CHAIRMAN. No objection.

Mr. BARNARD. All right.

I want to reiterate, what were the losses to depositors in this transaction?

Mr. KLINE. Zero.

Mr. BARNARD. What were the losses to any bank, except BNL?

Mr. KLINE. Zero.

Mr. BARNARD. Was there any undue enrichment on the part of the officers who victimized the banks; what was their reward? I mean, how did they—what did they—how did they use this to enrich themselves?

Mr. TAYLOR. Again, Mr. Barnard, you know, there is a criminal investigation, and I apologize, but I think it would be—

Mr. BARNARD. In other words, they were not just doing this for fun?

The CHAIRMAN. Well, if the gentleman will yield, nobody was doing this for fun. I mean, they are into making money; they are not—nobody is doing this for fun. But the gentleman is treading on ground now that is beyond the scope of this hearing.

Mr. BARNARD. Well, nowhere in any of the publicity that I have seen, any addressing of the defalcation and how it has affected those who have been accused, and, of course, I realize that that is—and I expect that. I expect that sincerely, and I will now close my inquiry.

The CHAIRMAN. Ms. Oakar.

Ms. OAKAR. Mr. Chairman, it seems that what we have are two issues. One is the issue that my friend from Georgia was raising relating to whether or not this cost the taxpayer money, and abiding by the law relative to the loans. The other issue, though, is the question of national security. That is where I would like to focus for a second.

Mr. Lombardi, is your institution predominately government owned?

Mr. LOMBARDI. Yes.

Ms. OAKAR. Is it owned by the government of Italy?

Mr. LOMBARDI. Yes.

Ms. OAKAR. You have a unique situation that is different from our country where most institutions are private.

In the testimony given by Mr. Dickerson, do you agree with his statement that at some point in the mid 1980s the management of BNL Atlanta entered into an agreement to loan a large amount of money, rumored to be \$2.1 billion to the government of Iraq. Then we are told that he says that BNL's capital management in Rome insists that it had no knowledge of the branch's activities.

Do you agree with that statement?

Mr. LOMBARDI. Yes.

Ms. OAKAR. I want to submit for the record about four articles that appeared in my local newspapers, Mr. Chairman, related to a firm called Matrix-Churchill. They just closed down a couple of weeks ago.

It is under investigation of being a front for funneling weapon-making machinery to Iraq, which would not be in the spirit of some of the credit areas that we have been discussing earlier.

Did you institution provide some of the financing for Matrix-Churchill in Solon, OH?

Mr. LOMBARDI. I am not aware of it. The matter is under investigation so I am not in a position not to answer because there is an investigation going on.

Ms. OAKAR. Well, the Italian treasury secretary apparently said they did before your Italian parliament. It is a matter of record, is it not?

Mr. LOMBARDI. I have no knowledge of it. The only thing I can say is that the matter is under investigation by the U.S. Department of Justice.

Ms. OAKAR. Yes, but there are areas of public information that, it seems to me, because you do have privileges in this country, we are not offended by having your institution in this country whatsoever. But there are some areas where public information related to your bank's activities is accessible.

So I think I could find that out. But you don't know?

Mr. LOMBARDI. I repeat, personally, I am not aware of it. I am not avoiding your answer. The only thing I am aware of is that there is an investigation ongoing dealing with all these matters.

Ms. OAKAR. But you don't know whether your institution made the loans that made it possible for the Export/Import Bank loans?

Mr. LOMBARDI. I don't think so.

Ms. OAKAR. You don't think so. Then all the articles written about your institution being the lending institution are inaccurate?

Would you say that is inaccurate? This is a chance to clear it up for your own institution's good name. But you don't think then that there were loans to this company?

Mr. LOMBARDI. I have no evidence and I have no direct knowledge of it.

Ms. OAKAR. What was the relationship between Mr. Pedde, the former President of BNL, and Mr. Drogoul, the former Manager of BNL in Atlanta?

Mr. LOMBARDI. This is another question I cannot answer because I am not aware of the personal relationship between the two gentlemen.

Ms. OAKAR. What is the chain of command when there is a large loan that is to be given by your institution?

Mr. LOMBARDI. In principle, we have some authority limits which go increasingly from a single branch to the regional management and then to our head office.

Ms. OAKAR. Did this loan of \$2.1 billion exceed the authority limits?

Mr. LOMBARDI. Yes, the current limits of the branches is \$500,000. \$2.5 million is for regional management. Everything that exceeds these limits has to be sent to Rome for authorization.

Ms. OAKAR. Mr. Chairman, my time has expired, but I ask unanimous consent for 1 more minute, if possible.

The CHAIRMAN. There being no objection, go ahead.

Ms. OAKAR. So you have limits. Is it a fact that this particular loan exceeded the limits and no one knew? How is that possible that Rome did not know that the limits were exceeded?

Mr. LOMBARDI. Actually, I cannot say anything. I think the investigation under way will explain the reasons why. But as far as I am personally concerned, I cannot answer this question.

Ms. OAKAR. Are there any other firms in this country to which your bank has supplied funds that have exported to Iraq, from this country? Is that a big part of your market in terms of financing?

Mr. LOMBARDI. I am now in charge of the operation of the bank. About the facts which pertain before the fraud was discovered, really I have no knowledge and there is an investigation underway.

So, personally, I hope as everyone hopes that once this investigation is over, we will have a clear picture of what happened in detail. But at this moment, really, I cannot speculate on the subject.

The CHAIRMAN. The time of the gentlelady has expired. The gentlelady sought unanimous consent to include in the record some newspaper articles.

Ms. OAKAR. Four articles.

The CHAIRMAN. Without objection, it is so ordered.

[The information referred to can be found in the appendix.]

The CHAIRMAN. Mr. Weiss, do you seek recognition?

Mr. WEISS. I was going to ask the witness to pull the microphone closer because I have difficulty hearing him.

With your permission, I have a couple of questions.

The CHAIRMAN. Mr. Weiss.

Mr. WEISS. Apparently, there seems to be agreement that there has been no cost to the American taxpayer or any of the funds that are involved in providing insurance. Is there any open-ended exposure still, Mr. Taylor?

Mr. TAYLOR. Not that I am aware of. We should differentiate as it relates to the obligations of the bank, BNL, and exposure created as a result of what the bank owes.

We feel the bank has stated, and stated here again, that it is good for all its liabilities when they are on book or off book. So it is prepared to pay to every one who is a creditor of BNL no matter whether they were recorded or not recorded on the books in Atlanta.

As it relates to the CCC loans, as I understand the program, it is a government program that basically gives to our exporter a guarantee as it relates to the payment by the receiving party on the shipment of grain. That exporter takes that guarantee and he funds the shipment of the grain by getting a bank to lend them the money against that guarantee of the U.S. Government through CCC. That is the part that is subject to question.

Mr. WEISS. That is my question.

Mr. TAYLOR. If Banco Lavoro had not made that CCC loan most likely it would have been taken up by another bank and things would have been very much the same.

Mr. WEISS. Are you saying that as regards to CCC guarantee that in fact there is potential exposure?

Mr. TAYLOR. Yes. That potential exposure comes from the issuance of the guarantee by the CCC. That is the action that causes the exposure.

Mr. WEISS. Even though the amount that has been guaranteed is beyond the level which was supposed to be authorized?

Mr. TAYLOR. No. The amount that was guaranteed, as I understand it, was not beyond the amount that was authorized by CCC.

What was beyond the authorization limits was the right of the Atlanta-BNL official to take in such a credit.

Mr. LOMBARDI. If I may point out, and I thank you for this question because it allows me to come back and refer to the CCC matter Mr. Wylie touched on before, one thing we take into account is that this transaction is not recognized but is just the BNL authority making this. Today they are fully legal and fully according to the American policy.

In fact those transactions have been supported by all the needed documents. At one point I would like to repeat what I just mentioned on page 4 of my statement where I say that BNL's participation did not increase or affect the amount of approved CCC exposure because the CCC exposures guaranteed that it is issued in order to—

Mr. WEISS. I understand that.

Mr. WYLIE. If the gentleman from New York would yield, I think you are making a good point. This follows up on a point I was making earlier. Even if Rome or New York were unaware that these loans were not authorized, would they not have to have knowledge of these loans when they were funded?

Mr. LOMBARDI. No, actually. The bank had no knowledge of this transaction.

Mr. WEISS. How many people worked at the Atlanta agency?

Mr. LOMBARDI. Presently?

Mr. WEISS. No, at that time.

Mr. LOMBARDI. At that time, there were 18 people.

Mr. WEISS. Were all 18 of those people involved in this deception?

Mr. LOMBARDI. This is a matter of investigation, once again. The Department of Justice is investigating all the matters.

Mr. WEISS. Were there people outside of the Atlanta agency involved at the bank who were involved in this deception?

Mr. LOMBARDI. Actually, once again, all the matters are under investigation. Personally, I cannot answer.

Mr. WEISS. Could the deception have been completed without people from outside the Atlanta agency being involved with it?

Mr. LOMBARDI. Yes, this could have happened.

Mr. WEISS. But it would require a total almost universal—except for perhaps the people who were not involved in banking work at that agency, involvement in this deceptive activity; is that right?

Mr. LOMBARDI. Yes, but I cannot speculate on the subject. I repeat this investigation will make clear what happened, we hope.

But at the moment I am not in a position to expand on the subject.

Mr. WEISS. Thank you, Mr. Chairman.

The CHAIRMAN. The time of the gentleman has expired.

I think this is a very critical point here. I think we ought to emphasize, we are not talking about the same thing when we use the same words, Mr. Barnard particularly, I want you to pay attention.

It is a fact, Mr. Lombardi, that last January, January 1990, the Iraqi government—you see unlike our system when it came time to negotiate the Iraqi government went to Rome and it met in January with the Italian government representatives.

Mr. LOMBARDI. Actually, they meet with some presidents of our bank.

The CHAIRMAN. Well, they met with agents of the government of Italy. At that point in January of this year, the Italian government sanctioned extension of credit to Iraq.

Mr. LOMBARDI. Actually, no, Mr. Chairman. This is wrong because there was no additional money granted. The agreement was just to make the bank recover.

The CHAIRMAN. In other words, you are not aware of the recorded \$2.1 billion loan the Iraqi government negotiated in January in Rome.

Mr. LOMBARDI. I know about this agreement but one thing I know about is that there was no additional money granted and no official Italian government officer who took part.

The CHAIRMAN. In other words, it was bank officials only?

Mr. LOMBARDI. Yes.

The CHAIRMAN. But there was extension of credit, whether it was additional credit or not.

Mr. LOMBARDI. Just a way to make a more secured understanding.

Ms. OAKAR. Mr. Chairman, would you yield?

The CHAIRMAN. Yes, I will be glad to.

Ms. OAKAR. The point is this was a government bank so the government is really in the meeting, right?

The CHAIRMAN. Well, we have a different tradition. This is the reason, Mr. Barnard, when you talk about extending powers to our bankers and changing the regulatory system where these powers would be extended so that they can compete with whom, Europe? In Europe you have a few select banks, you have a highly centralized system. You have most government owned, whether it is France, you have government owned banks, whether it is West Germany, whether it is Italy or any others.

The bankers, the private bankers or the banking officials have a tradition in Europe of public service. We don't have that with our private bankers in the United States, Mr. Barnard. We don't have that tradition.

So we are not talking about any kind of similarity or confluence in our systems.

Mr. BARNARD. Mr. Chairman, since my name was mentioned, would you yield?

The CHAIRMAN. Of course. You mentioned mine and I will mention yours.

Mr. BARNARD. I hope next year at least if not sooner, that we will be in a full fledged discussion of this subject in the Banking Committee.

I want the record to show that I am not advocating expanded powers. Nothing that I have said in the last 2 years has indicated that I am for expanded powers in banks. There is a big difference between expanded powers and restructuring. I am endeavoring and hoping that we will see the need in order to help the banking industry, help the economy, to make our whole financial system whether it be securities, real estate, insurance or so forth, more competitive in the global marketplace.

I think the answer is restructuring. At no time did I say we are looking for expanded powers.

I would also say I think we also should have a hearing as to what kind of public service banks provide in their community. They provide a lot of public services. It is not as much as some would like so, therefore, we have the CRA, the Community Reinvestment Act. I think it is substantial. I think that banks do provide a very substantial public service.

The CHAIRMAN. Yes, I appreciate the clarification on the part of my colleague. The gentleman knows, God willing and us returning, that is what we intend to do in the 102nd Congress.

Before we leave off here, I think it is important that we clarify the record.

Mr. Lombardi, in your testimony you revealed that BNL is a victim of rogue employees. You state that news of the unauthorized loans stunned BNL. But there is evidence to indicate that BNL employees in Rome as well as BNL in New York were aware of the Atlanta agency's activities.

In testimony before the Italian Parliament, the Italian Minister of Treasury Carli states he knew the finance section of BNL, knew of the Atlanta loans and were using such loans to finance Italian exports to Iraq.

He also made clear that as far back as December 19, 1988, the New York office of BNL knew of the Atlanta agency's supposed unauthorized dealings with Iraq because his investigation uncovered a telex received by New York indicating a \$26.4 million loan from Atlanta for Centrifugal Casting Machine Company, Incorporated that was done on the order of the Iraq Central Bank.

Do you say that neither the New York office or for that matter as stated by this minister, Rome, knew something about the Atlanta agency's unauthorized loan to Iraq as far as back as December 19, 1988?

Mr. LOMBARDI. Mr. Chairman I am aware of the reports to the Italian Parliament but as of this date I have no news. There is no evidence which leads me to any conclusion.

As you may appreciate, all these subjects to under investigation just to clarify if there was anything. But, once again, everything is under investigation. This is the reason why we hope once this investigation is over we will have a very clear picture of what happened.

The CHAIRMAN. Thank you very much.

Are there further questions?

Mr. WYLIE. I have no further questions.

Ms. OAKAR. Mr. Chairman, I don't think I am jeopardizing the case if I put in the record what is already public information in Italy which everyone has access to.

There was a Senate special committee Tuesday, May 19, 1990, under the Chairship of Chairman Carli, the Minister of the Treasury. He took the floor. In reference to the question I asked you, it indicates the parties voted to cancel two letters of credit, General Motors for \$114 million and a letter of credit to Matrix Churchill for \$70 million. So, in fact, there was a loan. There certainly were perhaps this and other transactions related to that company that is close to the district I represent.

I would like to ask unanimous consent, Mr. Chairman, that I be allowed to put this committee hearing in Italy in the record.

The CHAIRMAN. I am sure the gentlelady means the translation.

Ms. OAKAR. The translation, thank you, Mr. Chairman.

The CHAIRMAN. Without objection, it is so ordered.

[The information referred to can be found in the appendix.]

The CHAIRMAN. Mr. Weiss.

Mr. WEISS. Mr. Chairman, maybe I missed this. I have just one or two questions.

I understand between 1988 and 1989 almost \$3 billion worth of these loans went to Iraq. Did your agency in Atlanta have an unlimited amount of monies available for loans or did they have to get approval from someone to make these loans?

Mr. LOMBARDI. About this subject, I have covered that in my statement.

Mr. WEISS. Give me an answer to my question. Was there a pot of money Atlanta could loan at their whim or would they have to check with Rome and say we have a request for an amount of loans and grant it?

How did the system work?

Mr. LOMBARDI. How it worked is another thing which is under investigation.

Mr. WEISS. You can't answer that question as to whether, in fact, Atlanta had an unlimited pool of money or whether they had to get approval from loan?

Mr. BARNARD. Would the gentleman yield?

Mr. WEISS. I will be pleased to yield.

Mr. BARNARD. I think what Mr. Lombardi has said was that there were some policies that the local management could not make more than a \$500,000 loan so, therefore, they had some limitations as to what they could do.

The whole problem, of course, is that there were two sets of books and they exceeded that \$500,000 without authority, as I understand it.

Mr. WEISS. I understand that, Mr. Barnard. But it just boggles my mind to think that you could have loans to this extent, \$3 billion, and it could go on on the basis of double-bookkeeping. It doesn't make sense. It seems that somebody along the line, somebody would say how much do you still have available for loans and check to see what is outstanding.

The responses don't make any sense.

Mr. TAYLOR. One of the problems with the ways the double-book operating was that to fund these loans, had they gone to Rome or New York they would have been above the authorized limit. So they would borrow in the Euro market funds as BNL Atlanta, BNL New York and Rome not having knowledge, as we are told, of these borrowings. They would then borrow as Banca Lavoro and lend as Banca Lavoro and there was no record other than in Atlanta in the grey book.

Mr. WEISS. There was no record in the Euro market records?

Mr. TAYLOR. There was a record in the institution that lent the money.

Mr. WEISS. And that was not reflected any place else?

Mr. TAYLOR. At Lavoro, no. It would be reflected on the lenders' books.

The CHAIRMAN. If you would yield to me here.

Didn't the Morgan Bank get involved in \$1 billion of this transaction? I am sure the Morgan Bank is a domestically-regulated bank. They just got new powers from the Fed.

Mr. TAYLOR. Morgan did not lend any money.

The CHAIRMAN. No, but they are a clearing bank. Don't they keep records?

Mr. TAYLOR. They keep records of what comes in and what goes out.

The CHAIRMAN. That was Mr. Weiss' question.

Mr. TAYLOR. That is correct. What I am saying is that the Banca Lavoro in Atlanta borrowed the money and they were not authorized by Rome to borrow it.

Mr. WEISS. The Euro people took it on the word of the bank in Atlanta that they had the right to borrow almost \$3 billion?

Mr. TAYLOR. I understand the confirmations sent to Atlanta saying do you owe us this money and the people in Atlanta said, yes, we owed it.

Mr. WEISS. And those people never checked with Rome to see if Rome knew they owed the money.

Mr. TAYLOR. These are procedures that need to be reviewed; you should always verify liabilities with the head office.

The CHAIRMAN. Not only Rome, but New York uses Morgan as its clearing agent. Why wouldn't they have some knowledge. I think that was the pertinent essence of Mr. Weiss' question. Somewhere you had to have somebody reporting something.

Well, in order to proceed, I do have one question I think we ought to bring out now while we have the witnesses here. Again, Mr. Lombardi, the auditing department of BNL led by Mr. Mezeri, did an internal audit of BNL Atlanta on September 2, 1988. This audit reported in a 75-page scathing report which stated: "Based on the audit findings the Atlanta agency's operation of accounting and internal controls were found to be in need of improvement."

The internal audit report says: "The Italian data preparation and its flow and input into existing systems does not comply with existing BNL practices and procedures and as such is deficient of sound practices and control."

Now, was this report forwarded to BNL in Rome?

Mr. LOMBARDI. Yes, it was.

The CHAIRMAN. Do you recall the date that was forwarded to Rome?

Mr. LOMBARDI. I can find out and be precise on the subject, Mr. Chairman.

The CHAIRMAN. Who was the BNL person in Rome in charge of the United States operations and would it be possible to report on whether he received a copy of this internal report?

Mr. LOMBARDI. BNL office of inspector's office was the office in charge of receiving this document.

The CHAIRMAN. Was this Mr. Desario?

Mr. LOMBARDI. No, he was deputy general manager while the inspector's office was in another office.

The CHAIRMAN. One more question and we can leave that open for the record in case you are not aware.

Do you know what was done with the internal audit report in Rome once it was received?

Mr. LOMBARDI. Actually, I don't know. I was not in New York at that time.

The CHAIRMAN. I think for the sake of time and I know that you have been here sitting all morning long, I think we will submit them in writing. You will get a copy of the proceedings of this morning's hearing and whatever member has by way of questions in writing, including myself, will be submitted to you in ample time for you to examine the transcript.

We are very grateful to each and every one of you for your cooperation with the committee.

Thank you very much.

Mr. LOMBARDI. Thank you, Mr. Chairman.

The CHAIRMAN. Our next panel, Mr. Stephen R. Steinbrink, Deputy Comptroller for Multi-National Banking, Office of the Comptroller of the Currency (OCC); Mr. Paul Fritts, Director, Division of Bank Supervision, Federal Deposit Insurance Corporation (FDIC); Mr. James Gilleran, Superintendent of Banking, California State Banking Department, representing the Conference of State Bank Supervisors (CSBS).

Gentlemen, if anyone of you has a time problem, maybe an airplane to catch, let us know and we will recognize you first. If not, why don't we recognize you in the order that we introduced you. That would start with Mr. Steinbrink.

STATEMENT OF STEPHEN R. STEINBRINK, DEPUTY COMPTROLLER FOR MULTINATIONAL BANKING, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. STEINBRINK. Mr. Chairman and members of the committee, thank you for the invitation to testify today about the Office of the Comptroller of the Currency's regulation and supervision of U.S. branches and agencies of foreign banks and, in particular, the OCC's Federal Branch Program.

We welcome the committee's interest in this area of bank supervision and appreciate the opportunity to share with you our efforts to assure the safety and soundness of the national banking system through the regulation and supervision of Federal branches and agencies.

OCC involvement in the regulation and supervision of branches and agencies of foreign banks began with passage of the International Banking Act (IBA) of 1978. The IBA affords foreign banks the opportunity to apply for a Federal branch or agency license in those States where the bank is not operating a State branch pursuant to State law and the establishment of a branch or agency is not prohibited by State law.

The IBA identified the OCC as the U.S. bank regulatory agency charged with primary responsibility for supervising Federal branches and agencies. The OCC is responsible for acting on applications to license Federal branches, performing examinations, and providing an overall system of supervision.

At present there are 80 Federal licenses in operation, most of which are located in New York City although 13 licensees operate on the West Coast. A single Federal agency operates in Miami, Florida. As of June 30, 1990, the 80 Federal licensees had approximately \$33.3 billion in total assets, \$13.1 billion in total loans and \$14.9 billion in total deposits. Total liabilities to nonrelated third parties amounted to \$29.3 billion. Seven Federal branches are retail operations insured by the FDIC.

Our approach to the supervision of Federal branches mirrors that utilized for national banks and is consistent with the national treatment of these banking entities provided by the IBA. The same cadre of national bank examiners that examine national banks perform annual examinations of Federal branches and agencies.

Our program of supervision begins with the licensing decision. Much like a national bank charter, the decision to grant or deny a license to operate is fundamental to proper supervision. The OCC, in acting on Federal branch applications, considers the financial and managerial ability of the applicant foreign bank and the proposed Federal branch, competition, the convenience and needs of the community to be served, economic conditions and the system of supervision in the home country, and international banking expertise.

If, after considering these factors, the OCC is not convinced the applicant foreign bank has a reasonable likelihood of success, a Federal branch license will be denied. Foreign banks currently holding a State branch or agency license desiring to convert to a Federal branch must have a record of sound operation as a State licensee in order to qualify for a Federal license. For Federal branch applications, this office contacts the home country supervisor as to the financial ability and record of performance of the parent bank.

The IBA requires the OCC to perform an examination of each Federal branch at least once each calendar year. The regularity of examinations assures compliance with the requirements of national banking law.

Generally Federal branches and agencies are exposed to the same risks, are subject to the same laws, rulings and regulations, and are examined in much the same way as a national bank. However, because they are not separate legal entities and are only extensions of the parent, their operations may differ in some areas.

For example, because Federal branches and agencies are an extension of the parent bank, they do not have a separate capital structure. Therefore, they are required to maintain a pledge of assets known as a capital equivalency deposit, more commonly known as a CED account.

The OCC has developed specific examination procedures and a series of Federal branch banking circulars to address supervisory, policy and operational issues which are of particular importance to these banking entities. The circulars provide guidance in areas such as allowance for loan and lease losses, capital equivalency deposit accounts, and funds due from home and related offices.

Finally, our examination of Federal branches and agencies is always tempered with common sense recognizing that these entities are U.S. branch offices of foreign banking companies which are

supported by the financial and managerial abilities of those companies.

The program of Federal branch regulation and supervision is administered by the Multinational Banking Department located in Washington, DC. The Multinational Banking Department reviews each Federal branch report of examination to ensure consistency of supervision across the country and a system of regulation which is consistent with the mandates of the IBA.

With regard to enforcement powers, the IBA empowered the OCC to issue such rules, regulations, and orders as deemed necessary by the OCC to carry out the provisions of the IBA. The same enforcement tools available to the OCC for national banks exist for Federal branches. Civil money penalties, cease and desist orders and other enforcement measures are available and have been used as enforcement and compliance tools.

During the last year we have issued seven enforcement actions. In addition, the IBA granted the OCC the authority to terminate the license of any Federal branch for noncompliance with any rule, order or regulation of this office. The OCC has not revoked a license, but our ability to recall or retrieve a Federal branch license remains the ultimate sanction.

In summary, the overall approach to the supervision of Federal branches and agencies integrates the program of Federal branch supervision and regulation with the system for supervision of national banks. We believe this approach provides for consistency and fairness and allows for the best possible employment of OCC resources.

The letter of invitation asked whether the regulatory structure governing U.S. branches and agencies of foreign banks is adequate or whether the fragmented structure that now exists (that is, the regulation and examination of these entities is divided among the OCC, the FDIC, the Federal Reserve as well as the 50 States) is prone to breakdowns such as the one that occurred in the BNL-Atlanta case.

Banca Nazionale Del Lavoro's Atlanta branch is not a Federal branch and is not subject to OCC supervision or regulation, and consequently, I cannot comment on that specific case. We do believe, however, that cooperation, communication, and sharing of information with other domestic regulators such as the Federal Reserve and FDIC and the home country regulator of the parent bank are essential to ongoing supervision.

Your letter also asked us to explain the OCC's role in regulating the U.S. branches and agencies of foreign banks and the type of examination the OCC conducts. The OCC conducts full-scope examinations of Federal branches and agencies including reviews of asset quality and other solvency-related issues.

As you may know, the Basle Committee on Banking Regulations and Supervisory Practices has agreed upon certain principles for the regulation and supervision of international banks. The committee has agreed that while there is a general responsibility on the host authority to monitor the financial soundness of branches of foreign banks, supervision of the foreign bank itself for safety and soundness is primarily a matter for the parent authority.

Despite the agreement in principle reached by the committee, the OCC continues to perform examinations of Federal branches including asset quality reviews, assessment of the allowance for loan loss of both a general and specific nature, as well as other solvency issues consistent with our responsibilities under the IBA. Our compliance efforts include a review for compliance with applicable banking law including the Bank Secrecy Act.

Finally, you asked the comptroller if we had "any recommendations for improving the regulation and examination of these entities." In performing examinations of branches owned by the same parent, our examiners share information about the branches, and supervisory efforts are coordinated so that all U.S. operations of the bank are reviewed at the same time.

Supervision as if there is one operation allows for consistency and efficiency in carrying out our supervisory responsibility. Our posture with regard to the other Federal bank regulatory agencies and the State banking departments remains one of communication and cooperation.

We share information with the Federal Reserve Board and the FDIC regarding such things as requirements of the Bank Holding Company Act, bank reserves, and insurance of deposits. As the primary supervisor of Federal branches and agencies, we have always tried to prevent duplication of effort by sharing information with other regulatory agencies and assisting them in the fulfillment of their responsibilities.

There also is a common interest in approaching the supervision of foreign banks on a basis consistent with the domestic counterparts. There should be equality of supervision and regulation as well as equality of competition.

Finally, we believe that banking regulators around the world must develop better systems of communication and cooperation. As global banking companies expand, mechanisms for sharing supervisory information between home and host country regulators must be developed in order to assure proper supervision of worldwide banking companies.

Thank you for the opportunity to share with you information about our efforts to provide proper supervision and regulation of Federal branches and agencies. I would be happy to respond to any questions.

The CHAIRMAN. Thank you very much, sir.

Mr. Fritts.

STATEMENT OF PAUL FRITTS, DIRECTOR, DIVISION OF BANK SUPERVISION, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Mr. FRITTS. Thank you, Mr. Chairman, and members of the committee.

I ask that our full statement be made a part of the record.

The CHAIRMAN. Certainly. Without objection, it is so ordered.

I will say the same for each of the witnesses. Your complete statements will be made a part of the record.

Mr. FRITTS. In deference to time considerations and because our prepared statement is duplicative of the testimony the committee

has already heard today, I will not waste your time by repeating that statement, thus my remarks will be quite brief.

FDIC assumes supervisory authority for State chartered insured United States branches of foreign banks.

With respect to the frequencies of such examinations, FDIC uses the same standards that are applicable to domestic FDIC supervised institutions.

For branches that receive a composite one or two rating, the maximum period between examines is 24 months. For those receiving a three, four or five, the maximum interval between examinations is 12 months.

With but few exceptions, our examination program is current, relating to those timetables for foreign branch offices. However, we at FDIC are currently, again, reviewing our examination program cycles with a view toward possible shortening of those cycles, probably to require at least some physical FDIC examination presence in all State nonmember banks of size each year regardless of their rating.

We believe at FDIC that the regulatory structure that exists for supervision of foreign bank branches and agencies is as adequate as it is for the banking system as a whole.

In the case of BNL in Atlanta, the case was one of massive fraud and it is very, very difficult for an examiner to detect shortages or fraud brought on by a duplicative set of books.

We have no specific recommendations relative to additional supervisory efforts for supervising branches. However, we will say this as we said some years ago in testifying about the International Banking Act, we want to point out the continued awkwardness of a system that insures only a part of an institution, that is a branch of a bank but not the entire institution.

As you know, BNL Atlanta, was not insured and thus the FDIC had no direct involvement. I would be pleased to address any questions that the committee members may have.

Thank you.

[The prepared statement of Mr. Fritts can be found in the appendix.]

The CHAIRMAN. Mr. Gilleran.

STATEMENT OF JAMES GILLERAN, CONFERENCE OF STATE BANK SUPERVISORS

Mr. GILLERAN. Again, Mr. Chairman, I have cut my even brief remarks even shorter.

I am the Superintendent of the Banks for the State of California and today I represent the Conference of State Bank Supervisors.

The State banking departments are the primary supervisors of State licensed foreign bank branches and agencies.

State banking departments perform the same functions with these entities as with domestic State-chartered commercial banks.

If a branch becomes financially troubled or commits a serious violation of law, the State supervisor has the full range of enforcement tools at his or her disposal, including closing the foreign bank branch or agency.

The vast majority of State-licensed foreign bank branches or agencies are examined annually. California alternates yearly examinations with the Federal Reserve.

In California, a foreign bank branch or agency is examined every year by one of the two regulators. New York performs examinations on either a 12- or 24-month cycle, depending on the entity's rating the strength of the parent, and the assessment of the country risk.

Any entity not on the 12 month, full-scope examination cycle is subject to special visitations. A few States require examinations every 18 months.

All examination reports are provided to the appropriate Federal regulator, the parent bank and its primary regulator.

Given the role of the Federal Reserve and the relatively few FDIC-insured foreign bank branches and agencies, the vast majority of cooperation takes place between the State regulators and the Federal Reserve and among the States themselves.

Our working relationship with the Federal Reserve is good. While the relationship varies from State to State, all report a close working relationship. We have excellent working relations with the FDIC.

A number of States recently signed an information-sharing agreement on the supervision of foreign banks. The signatories to this agreement are California, New York, Illinois, Florida, Georgia, Michigan, and Washington.

This agreement provides for the confidential exchange of information between the States about foreign banks operating within their borders.

We anticipate that other States will sign this agreement. The agreements aim is to further strengthen State supervision of the entities and to provide a means for monitoring foreign bank entry and activities in other States.

Mr. Chairman, I have a copy of this agreement and would ask that it be included in the record at the appropriate place.

The CHAIRMAN. Without objection it will be included.

[The information referred to can be found in the appendix.]

Mr. GILLERAN. You asked for our recommendations on improving the regulation and examinations of these entities.

First is in the area of cooperation. The IBA requires consultation with the States by the Federal Reserve on a number of matters.

The consultation on policy issues should be more regular, and formalized consultation should be taken place when major issues are on the table. Regular meetings should be scheduled between the Federal Reserve and all State regulators who have responsibilities over foreign bank branches and agencies.

The States should be represented by one of our own in the international meetings that impact on the foreign bank branches or agencies we regulate, as well as the domestic State banking system. The Basle Committee is the primary vehicle for the international coordination of bank supervision. The committee is made up of two representatives from 10 of the 12 industrialized countries, generally referred to as the G-12 nations.

Luxembourg has only one representative and the United States has at least four. None of these four United States representatives

represents the States directly in their role with foreign bank branches or domestic State banks.

States charter and regulate over 40 percent of the domestic bank assets and over 80 percent of the foreign bank assets. Given these facts and the scope of the impact of the Basle Committee's deliberation and decisions on State-regulated institutions, the lack of direct State participation is unjustifiable and deserves this committee's attention.

Our third and final recommendation at this time is the expansion of the Federal criminal code to include crimes by employees of foreign bank branches or agencies.

We supported your efforts, Mr. Chairman, to address this issue in the crime bill, and were disappointed to see that the provisions were not offered. By subjecting these individuals to criminal sanctions under Title 18, you will bring the substantial resources and expertise to the U.S. Attorney's offices and the Justice Department to bear on these cases.

These penalties would be in addition to current State criminal sanctions, and provide increased deterrence to individuals considering criminal acts.

This is not to say that the individuals under investigation in the BNL incident will not be subject to criminal prosecution under current law. The State criminal system provides timely and substantial justice to those accused of fraud. We have recently seen this in action in the Keating case.

As you have pointed out, Mr. Chairman, this case appears to have involved massive fraud.

This type of fraud is difficult or impossible to detect, and this criminal activity may be successful for a short period of time. However, the combination of internal controls and audits, external audits, and on-site regulatory examinations will ultimately bring this activity to light or drive one of the conspirators to come forward.

During the on-site examinations, examiners will often receive tips from bank employees and others regarding fraudulent activities.

It is fraud, not a breakdown in the regulatory system of foreign bank branches and agencies, that is present in this case. From the information available to us, it appears that the regulatory system worked.

However, Mr. Chairman, this fraud must be examined by regulators to see if any new examination technologies should be considered.

Foreign bank branches or agencies have adequately regulated, supervised, and examined under the current regulatory scheme.

They receive timely on-site monitoring activities. They receive the same regulatory review as domestic State-chartered banks.

We see no need at this time to change the structure of the supervisory system for foreign bank branches and agencies.

Thank you, Mr. Chairman. I will be glad to take your questions. [The prepared statement of Mr. Gilleran can be found in the appendix.]

The CHAIRMAN. Mr. Taylor, were you going to present a statement?

Mr. TAYLOR. I have already done so.

The CHAIRMAN. I have a few questions for the record and maybe a couple now.

Mr. Taylor, New York conducts its own examinations, Texas conducts joint and California alternates with the Federal Reserve on a yearly basis. Most States have the principal responsibility for examining State branch licenses and, wouldn't it be better for all to have the same arrangement for the State-licensed entities? We can get the answer in writing.

[The information referred to can be found in the appendix.]

The CHAIRMAN. The testimony just presented by Mr. Gilleran, it was suggested that the conference of State banking supervisors have representatives in the consultation and policy issues regarding foreign banking supervision with all States, in other words, represented on the Basle Committee deliberations.

Again, we would like to know your reactions.

I will have about four additional questions in writing I will submit.

Mr. Wylie.

Mr. WYLIE. Mr. Chairman, I ask unanimous consent to submit some questions in writing.

The CHAIRMAN. Without objection, it is so ordered.

Mr. WYLIE. Mr. Gilleran, the scandal at BNL, as well as the activities of State-chartered thrifts has caused great exposure to the insurance fund and has led some of us to question the dual banking system in the present form.

What can you tell us on behalf of the State banking regulators as to why we should continue the dual banking system?

Mr. GILLERAN. What a wonderful question. Thanks for asking. I think it is extremely important that a dual banking system be continued.

First of all, it has been the place in banking systems where most of the creativity has come in the past where new ideas have been tried out on the State level and adopted eventually nationwide.

So that as a crucible for change it has provided some wonderful ideas that have been later adopted nationwide.

Mr. WYLIE. And some not so wonderful like junk bonds and other investments.

Mr. GILLERAN. There have been others developed by the States, NOW accounts and other types of financing transactions. In addition the State system has been primarily made up of the small community banks around the United States.

These community banks have been providers of credit to small and medium-sized businesses since the start of the system and the small and medium-sized business is where most of the creative ideas come from in the United States.

Before we tamper with the dual banking system, we should very well consider how businesses are formed in this country, how they are financed and how they are developed.

So that system is a very important one for the whole United States economically.

Mr. WYLIE. I thank that chairman.

He and I both want to go vote.

I don't believe he wants to have you wait. I have a couple of follow-up questions and a couple for Mr. Taylor and Mr. Steinbrink which I will include in the record.

The CHAIRMAN. Thank you gentlemen very much.

We apologize for keeping you so long.

If any of you have a closing statement you wish to make, we have 1 or 2 minutes.

We have about 3 minutes left to vote.

Thank you very much for appearing here today.

The committee will be adjourned.

[Whereupon, at 2:20 p.m., the hearing adjourned.]

**Opening Statement of Henry B. Gonzales, Chairman
Committee on Banking, Finance and Urban Affairs**

**Full Committee Hearing on the
Banca Nazionale del Lavoro (BNL) Affair**

October 16, 1990

The Banking Committee is meeting today to hear testimony regarding the scandal involving the Atlanta branch of Banca Nazionale del Lavoro. This is a sensational case in which former employees of the Atlanta Branch of BNL approved approximately \$3.065 billion in secret and unauthorized loans to Iraq. Only \$67 million of this amount was reported to state and federal bank regulators. BNL-Atlanta also failed to report \$1.8 billion in monies borrowed in the world money markets to support its concealed loans.

Press reports and the Italian government have linked BNL financing to companies that sold armaments to Iraq over the past several years. At this time the Committee has no proof of that assertion, but at a minimum, the secret loans mentioned above increased Iraq's credit capacity and permitted Iraq to spend their scant hard currency on some of the very weapons that are now aimed at our children.

The BNL affair is also a case study in regulatory failure. The state and federal regulatory agencies not only failed to adequately supervise BNL, but they still insist they are blameless for not discovering this massive fraud.

The BNL affair raises several larger concerns. Foremost is the adequacy of the regulation and supervision of U.S. branches and agencies of foreign banks. Entities like BNL command over \$575 billion in assets in the U.S. and over \$7.5 billion of their liabilities are guaranteed by the FDIC.

The regulatory scheme governing branches and agencies of foreign banks is spelled out in the International Banking Act of 1978. The Banking Committee is quite concerned that the present sharing arrangement between the state and federal bank regulatory agencies is inadequate to ensure these entities are properly supervised. This was certainly the case in the BNL affair. It is apparent that a thorough review of the International Banking Act is in order.

The BNL affair also raises the issue of whether or not we should allow U.S.-based financial institutions to be used as a conduit of foreign policy. It is time the Committee delved into the intentions of foreign banks, especially those owned by foreign governments, and the role they play in our economy. We should ask ourselves: Even if it did not happen in the case of BNL, should we permit foreign governments to carry out their foreign policy through our banking system, especially if it goes against our own foreign policy? Should we permit foreign banks that are underwritten by foreign taxpayers to compete head on with our privately owned banks?

One must wonder if it is fair for a foreign government-owned bank to take business and jobs away from our privately owned domestic banks.

Maybe it is time we established a national screening board to monitor more closely foreign bank presence in the U.S. Such a screening board could review applications for foreign bank entry into the U.S. as well as monitor these banks to ensure they are not engaged in foreign policy activities.

There are several primary reasons that the BNL affair occurred. First, BNL was a pitifully managed organization. An internal 75-page audit of BNL-Atlanta that was conducted one year before the scandal became public, paints a clear picture of an organization out of control. This internal audit stated, and I quote, "Based on the audit findings, the Atlanta agency's operations, accounting and internal controls were found to be in need of improvement in most areas." The internal audit report goes on to say, "the accounting data preparation and its flow and input into existing systems does not comply with existing BNL practices and procedures and as such is deficient of sound practices and controls."

What is most distressing about the audit findings is that BNL concealed them from state and federal bank regulators. Upon examining BNL, the State of Georgia asked for a copy of the internal control report. BNL-Atlanta management falsely told the

Georgia examiners that the report was still in progress and was unavailable.

The State of Georgia examiners never followed up to get a copy of that report. They also did not do their own comprehensive examination of BNL. The State of Georgia gave BNL a clean examination report. The Federal Reserve, which has prime responsibility to ensure the state exams are adequate, did nothing to ensure Georgia did a good job. The Fed only spent a few hours on the BNL audit.

Ironically, not long after the BNL exam, the manager of the Atlanta branch signed a \$1.1 billion unauthorized loan agreement with Iraq. Apparently the BNL people were convinced the examiners would not catch them and that the management of BNL would not detect nor stop them.

This hearing is also being held to acquaint Members with a loophole in the criminal code that today permits employees of branches and agencies of foreign bank to escape federal prosecution for bank theft, fraud, embezzlement, misapplication of funds and bribery. The Federal Reserve has asked us to close this loophole, and it is imperative Members fully understand the reasons for this legislative request.

Today's witnesses are:

TESTIMONY OF F. PAUL DICKERSON
ASSOCIATE ADMINISTRATOR, FOREIGN AGRICULTURAL SERVICE &
GENERAL SALES MANAGER, COMMODITY CREDIT CORPORATION

BEFORE THE COMMITTEE ON BANKING AND FINANCE
UNITED STATES HOUSE OF REPRESENTATIVES
OCTOBER 16, 1990

Mr. Chairman and Members of the Committee: I would first like to thank the Committee for inviting me to appear today and present the views of the U.S. Department of Agriculture ("USDA") and the Commodity Credit Corporation ("CCC") regarding the concerns that have surfaced in the last year as a result of the investigation of the Atlanta agency of Banca Nazionale del Lavoro (BNL).

I know that the Committee has already been briefed by its staff regarding the issues and allegations surrounding the Atlanta investigation of BNL, and I will not go into great detail about those matters.

The basic facts, as we now understand them, are these: At some point in the mid-1980's, the management of BNL Atlanta entered into an agreement to loan a large amount of money -- rumored to be in excess of \$2.1 billion -- to the Government of Iraq and its instrumentalities. We are told that BNL's central management in Rome insists that it had no knowledge that the Atlanta branch had committed to make these loans to Iraq, and that the amount pledged was far in excess of the lending limits established for the Atlanta branch. According to BNL, the loans

were concealed from both the bank's regional management in New York and its central management in Rome, and that the loan arrangement with Iraq represented "rogue" activity by the Atlanta branch personnel. This allegedly unauthorized loan activity was purportedly conducted on a secret set of accounts -- or "greybook" -- and the loans were financed through an intricate scheme of borrowing in the interbank money markets.

At the time the Atlanta investigation was first brought to CCC's attention in September, 1989, BNL held approximately \$750 million in receivables due in the future from Iraq, representing payment obligations under letters of credit that had been assigned to BNL by U.S. agricultural exporters and for which payment guarantees had been issued by CCC under the GSM programs. Because Iraq continued to pay on those obligations up until August 2 of this year, the outstanding obligations of Iraq held by BNL and guaranteed by CCC have been substantially reduced, and today total approximately \$347 million.

Those letters of credit had been issued by Bank Rafidain, an instrumentality of the Government of Iraq. To CCC's knowledge, Iraq had made payments on all of its GSM-102 obligations, including all payments due under letters of credit assigned by exporters to BNL up until the time of the invasion of Kuwait. As of August 1, however, Iraq (and Bank Rafidain) have stopped making payments on obligations owed to the United States, and CCC

has been notified by a number of banks, including BNL, of Iraqi default on GSM-guarantee transactions.

So that the Committee can appreciate CCC's specific interest in the BNL-Atlanta situation, I would like to describe briefly just how the GSM export credit programs work.

The Operation of the GSM Programs

The GSM-102 and GSM-103 programs are export credit guarantee programs operated by the CCC under the general authority of section 5(f) of the Commodity Credit Corporation Charter Act of 1948, by which CCC was directed by Congress to develop programs to "export or cause to be exported, or aid in the development of foreign markets for, agricultural commodities...." 7 U.S.C. 714c(f). Congress did not provide specific guidance regarding the means for carrying out this mandate, leaving the formulation and operation of specific programs to the judgment and discretion of CCC.

The GSM programs evolved in the 1970's from the need to find export markets for the increasing levels of U.S. farm production. The concept was to develop programs which would permit U.S. agriculture to develop, and establish itself in, new markets. USDA saw the potential for additional sales in a number of countries in which significant additional demand would exist if

credit were available. These were countries that, due to financial constraints, could not purchase additional amounts in the customary cash markets, but were interested in and able to purchase on credit.

In the 1970's, CCC assisted U.S. exports through the operation of direct credit and blended credit programs. In the early 1980's, CCC devised two programs -- GSM-102 and GSM-103 -- utilizing credit guarantees, thereby permitting CCC to continue to assist U.S. export sales without providing direct credit. Essentially, the CCC guarantee operates to attract credit from the private sector to finance sales of U.S. agricultural commodities, rather than having the government provide credit directly.

The principal and most significant difference between the GSM-102 and GSM-103 programs is the length of credit terms. Under GSM-102, CCC guarantees repayment for credit sales of three years or less; under GSM-103, CCC's guarantees cover credit sales of more than three but less than ten years, with seven years being the typical repayment period. Regulations for the operation of the programs were promulgated and codified at 7 CFR Part 1493.

As part of the Food Security Act of 1985, Congress established benchmark levels at which it expected CCC to operate

these programs. In the case of GSM-102, Congress has mandated that CCC make available "no less than \$5 billion" annually in short term credit guarantees; in the case of GSM-103 intermediate export credit guarantees, Congress established a ceiling level which, for the most recent fiscal year, was \$1 billion.

The programs operate as follows: CCC has identified a number of countries which are appropriate participants in the GSM programs. Essentially, GSM participant countries are those which have potential for additional food purchases, but could not make those additional purchases in the cash markets -- e.g., Mexico, Algeria, Morocco, etc. The determination of participant countries involves an evaluation of long term food needs, interest in the program, market development opportunity for U.S. commodities, and ability to repay any credit extended.

Because GSM sales must be made pursuant to a foreign bank letter of credit -- an issue I will discuss later -- CCC also qualifies specific banks in the participating foreign country which are eligible to issue deferred payment letters of credit in conjunction with GSM-guarantee sales.

Prior to the beginning of each fiscal year, USDA, through its commodity divisions and the attache service of the Foreign Agricultural Service (FAS), through discussions with foreign countries interested in the programs and with input from the U.S.

export industry, identifies the most favorable opportunities for credit sales under the programs. FAS then allocates the amounts of credit guarantees among potential participating countries, establishing specific country "lines" by commodity. These proposals are presented to an interagency group -- the National Advisory Council on International Fiscal and Monetary Policy (NAC) -- for its advice.

Once country lines have been established, they are announced to the trade. An exporter who makes a credit sale to a GSM participating country on appropriate terms can apply, in accordance with the terms of the program regulations, for a CCC payment guarantee. If there is sufficient credit guarantee availability for the commodity and country identified in the sale, CCC will issue a provisional export credit guarantee to the exporter. The guarantee becomes effective at the time the commodities are exported from the United States.

Under the program regulations, sales must be made subject to repayment on deferred terms under a letter of credit issued by an approved foreign bank. The CCC guarantee is a promise to the exporter that CCC will pay the exporter, or its assignee, for the sale in the event that the approved foreign bank should default on its payment obligation under the letter of credit. It is important for the Committee to understand that this is the only risk assumed by CCC under the GSM program -- the risk of non-

payment by an approved foreign bank issuing an international letter of credit.

Once the exporter receives the GSM guarantee and has exported the commodity in accordance with the terms of its letter of credit obligations, it is free to "assign" its rights to proceeds under the letter of credit (and its rights to receive payment under CCC's guarantee in case of default) to a U.S. financial institution. Put more simply, this "assignment" of rights means that the U.S. exporter is able to receive immediate payment for its sale from a U.S. bank and "cash out" of the transaction. Most banks that take such assignments then book these transactions as "loans" made to the foreign bank that is obligated to make deferred payments under the letter of credit. The risk of repayment is passed to the U.S. bank which effectively undertakes to finance the credit sale. This is, of course, the entire purpose of the program. U.S. exporters are ordinarily not in (and do not want to be in) the business of financing credit sales; the purpose of the GSM programs, as I mentioned earlier, is to attract marketplace financing.

The Committee should also note that CCC does not issue credit guarantees to U.S. banks. Guarantees are issued to the agricultural exporters, who subsequently negotiate the guarantees to financial institutions interested in having these types of "loans" in their portfolios. As a result, CCC has no

programmatic relationship with banks located in the United States under the GSM-102 and GSM-103 programs, nor any regulatory oversight. More importantly, CCC assumes no risk whatsoever with respect to the U.S.-based financial institutions that take assignments of GSM guarantees. Whether the guarantee is held by the exporter or by its assignee, CCC's risk remains identical -- it is the risk of non-payment by the foreign bank issuing the letter of credit. Accordingly, the only requirement imposed with respect to assignment is that the assignee be a financial institution located in the United States.

Sales to Iraq under the GSM programs

Iraq began purchasing U.S. commodities under the GSM program in 1983 when the United States and Iraq were working to reestablish diplomatic relations that had been severed for almost seventeen years. Iraq was, at that time, engaged in the middle of its eight year war with Iran and was looking for a means of obtaining food and feedstuffs on credit. At the same time, the United States was experiencing a surplus of many commodities, and it was determined that Iraq's long-term food needs presented significant market development potential for a number of U.S. commodities.

In 1983, Iraq purchased \$364 million of U.S. agricultural commodities under the GSM-102 program. The program grew in most years during the 1980's, with peak allocations during FY'88 and FY'89 of slightly more than \$1 billion annually. A summary of the export values guaranteed during the period is set forth in Attachment A.

As part of the process of establishing country allocations, representatives of USDA ordinarily held consultations with representatives of Iraq each year in the late summer or early autumn to determine Iraq's specific interests in GSM purchasing. These consultations were held either in Baghdad or Washington. Because Iraq is a centrally planned economy, all of its GSM purchasing was conducted through various government ministries. The Iraqi delegations to these consultations were ordinarily led by officials of the Iraqi Ministry of Trade, and included representatives from the various purchasing ministries. The U.S. delegation consisted of representatives of CCC's Office of the General Sales Manager and of FAS officials in charge of program operations. Oftentimes, U.S. officials also met with representatives of the involved Iraqi financial institutions -- the Central Bank of Iraq and Bank Rafidain.

From the time the program for Iraq was initiated in 1983 until the invasion of Kuwait, Iraq purchased approximately \$5 billion in U.S. agricultural commodities under the GSM programs.

CCC records indicate that it did not receive any claims or incur any losses with respect to guarantees issued in conjunction with sales to Iraq. Based on the value of guarantees issued over that time period which have lapsed without the filing of any claims, CCC estimates that Iraq paid approximately \$3 billion in principal amounts due plus interest. On a few occasions, CCC did receive notice of late payment from assignee banks; however, on each of those occasions, it was determined that the late payment had occurred because of difficulties in the international funds transfer process, and within a very short time, payment was received and Iraq was determined to be current on its GSM-guaranteed obligations. I would note that CCC received no claims on guarantees issued in conjunction with Iraqi sales even after the BNL investigation began in Atlanta up until August 1 of this year.

This situation has now changed drastically. As of August 1, Iraq stopped payment on all of its foreign debts. Unpaid Iraqi obligations for which CCC has issued guarantees under the GSM-102 or GSM-103 programs total approximately \$2 billion. This represents approximately \$1.6 billion in principal obligations, and the remainder in guaranteed interest. The majority of these obligations result from sales made under the GSM-102 program, and those obligations will come due over the next three years. A smaller percentage -- less than \$200 million -- represents

repayments on sales made under the GSM-103 program which will come due over the next five years.

The receivables for those obligations, and the rights to proceeds under GSM guarantees, are currently held by eleven different U.S. based-banks, some of which are U.S. banks and some of which are U.S.-based branches or agencies of foreign banks, including BNL. CCC is authorized to accept and pay on valid claims, and is currently in the process of evaluating all claims on a case-by-case basis. According to CCC records, BNL currently holds receivables, for which CCC guarantees have been issued, of approximately \$347 million. In addition to the GSM-guaranteed financing it provided in conjunction with sales to Iraq, BNL has also financed GSM-guaranteed sales to seven other countries, totaling approximately \$242 million.

After the U.S. Attorney in Atlanta began its investigation of BNL last year, CCC took several actions. First, it was determined that only \$500 million of credit guarantees should be allocated to Iraq, which represented about one-half of the level requested by Iraq and about one-half of the level allocated in each of the prior fiscal years. Second, CCC initiated an administrative review of the program with Iraq to determine, based on the information available to CCC, whether there might have been any program abuses associated with the transactions for which BNL had accepted assignment of proceeds.

When the Atlanta investigation began, very little was known about what might have transpired at BNL. In general, it appeared that the investigation involved primarily issues of bank fraud and evasion of bank regulatory requirements. There was no information available for CCC to determine whether BNL had been involved in any irregularities with respect to any CCC-guaranteed transactions.

For that reason, CCC initiated its own administrative review of the GSM program with Iraq. That process involved review of BNL's GSM records, certain exporter records, historical commodity prices and CCC records. In addition, I headed a team which travelled to Baghdad in April to review Iraqi records and to meet with Iraqi officials within the Ministry of Trade. The report of that administrative review was released publicly in May, 1990, and a copy has been provided to your staff. In addition, an executive summary of the findings and conclusions of that review are provided with this statement as Attachment B.

As you will note from that summary, one area of concern was the issue of so-called "after sales service." In CCC's administrative review, it was learned that Iraq had a fairly regular practice of requesting that U.S. exporters operating under the GSM program provide rebates or discounts, often in the cases of additional goods such as truck tires or equipment. It appears that, in some cases, exporters failed to reduce the "port

value" reported to CCC at the time guarantees were obtained by the value of these additional goods, which failure would represent a program violation on the part of the exporter. At the conclusion of its review, CCC turned over the information it had developed to USDA's Office of the Inspector General, asking that it conduct a thorough investigation of all sales to Iraq to ascertain the extent of this practice. The OIG is completing its study and we expect a final report soon. CCC will take appropriate administrative or civil action in the event that the OIG report discloses wrongful violation of program requirements.

In conclusion, I would note the following points for the Committee:

First, in the absence of a settlement to the current crisis in the Mideast, CCC expects that Iraq will continue in default on its obligations to U.S. banks for which repayment has been guaranteed by CCC under the GSM-102 program. Potential exposure for CCC as a result of those guarantees is approximately \$1.9 billion. CCC exposure is a result of non-payment of obligations by Bank Rafidain under letters of credit issued by that bank.

Second, CCC is continuing to monitor the investigation of BNL in Atlanta to learn whether any program violations uncovered in that investigation will require appropriate

administrative or civil action. However, because CCC does not assume any risk with respect to U.S. banks, CCC's potential exposure relates to non-payment of obligations by Iraq and is unaffected by the circumstances that are under investigation at BNL Atlanta.

I would like to thank the Committee for this opportunity to appear before it, and would be happy to respond to any questions.

Attachment A

SUMMARY OF SALES APPROVED UNDER CCC CREDIT GUARANTEE PROGRAMS FOR IRAQ
(MILLIONS)

<u>FISCAL YEAR</u>	<u>GSM-102</u>	<u>GSM-103</u>	<u>TOTAL</u>
1983	\$ 364.5	\$-0-	\$ 364.5
1984	646.1	-0-	646.1
1985	340.1	-0-	340.1
1986	392.9	9.7	392.9
1987	652.5	85.1	652.5
1988	1,112.1	83.3	1,113.1
1989	1,088.8	38.4	1,088.8
1990 (1)	495.4	-0-	481.2
Total	4,862.7	216.5	\$5,079.2

(1) Includes approximately \$100 million of GSM-102 sales to Iraq that had been approved but not exported as of August 2, 1990. Since exports were suspended effective August 2, 1990 to Iraq, CCC will not be exposed to these transactions.

Attachment B

EXECUTIVE SUMMARY

REPORT: USDA ADMINISTRATIVE REVIEW OF IRAQ GSM-102 PROGRAM

In October, 1989, the U.S. Department of Agriculture and the Commodity Credit Corporation (hereinafter "USDA") initiated an administrative review of certain aspects of the Export Credit Guarantee (GSM-102) program for Iraq. This administrative review was undertaken in response to allegations that surfaced as a result of the investigations of the Atlanta, Georgia agency of Banca Nazionale del Lavoro (BNL), about possible irregularities in the GSM-102 program for Iraq. This review focused on certain transactions and issues that were identified as a result the BNL investigation in Atlanta.

Iraq began participating in the GSM-102 program in 1983 during which approximately \$214.7 million in sales of agricultural commodities were guaranteed by CCC. Program levels increased each year thereafter, reaching a high of \$1.051 billion in FY 1989. For FY 1990, program levels were set at \$500 million, and to date, nearly all of that line has been registered for guarantees with CCC.

Review of the Iraq GSM-102 program began last fall after USDA learned of allegations that approximately \$720 million of CCC-guaranteed loans were part of a loan portfolio being investigated by the Office of the United States Attorney for the Northern District of Georgia. Allegedly, the CCC-guaranteed loans were part of a clandestine loan operation in which officials of the Atlanta branch of Banca Nazionale del Lavoro (BNL) had booked more than \$2 billion in unauthorized and unreported loans to Iraq.

As a result of its initial inquiries into these loans, USDA initiated an administrative review focusing on the following issues:

- o unusually high FOB prices obtained by exporters in connection with GSM-guaranteed sales to Iraq financed through BNL;
- o the arrival in Iraq of agricultural commodities shipped under the GSM program.
- o provision of additional goods or monetary rebates, as so-called "after sales service", in connection with GSM-guaranteed export sales to Iraq.
- o payment of certain Iraqi domestic taxes in conjunction with GSM-guaranteed sales.

The USDA administrative review has involved review of BNL records of GSM-102 transactions; review of CCC records; review of a certain exporter records; telephone interviews with several companies involved in the agricultural export trade; and discussion with officials of the Government of Iraq and its various state purchasing enterprises, and review of Iraqi records, during a visit to Baghdad on April 18-22, 1990.

As a result of its administrative review, and its analysis of bank, exporter and Iraqi records, USDA has reached some initial conclusions about past conduct of the Iraq GSM-102 program. They are as follows:

(1). USDA analysis indicates that during the period 1985-1987, sale prices to Iraq for corn, rice and sugar under the GSM-102 program were much higher than price levels in other markets. Price levels paid by Iraq appear to be at least \$10/MT higher than benchmark world prices for rice and corn, and \$15-40/MT higher for sugar. It appears that these price levels may have resulted in part from supplier perceptions that Iraq was a very high risk market due to wartime conditions; because of the limited number of U.S. suppliers who were willing to participate in this high risk market; and, Iraq's policy of seeking freight financing which only a limited number of suppliers able or willing to provide.

(2) In some of the higher priced transactions reviewed, it appeared that a portion of the high FOB prices reported to CCC -- approximately \$8-10/MT -- represented an allocation by the exporter of what should have been considered either freight costs or freight financing charges. It appears, therefore, that some this "allocation" technique may have been used to shift some of the freight financing of a C&F sale to the loan guaranteed by CCC during a time period in which CCC did not permit financing of freight under its guarantees, and that Iraq agreed to these allocations. This practice may have constituted violations by certain exporters of program regulations. While these allocations did not result in any losses to CCC or the U.S. Government, they did result in a diminution of guarantee amounts available under the program.

(3) The USDA administrative review uncovered no evidence to suggest that there has been diversion of commodities sold to Iraq. The lack of "proof of arrival" in either bank or exporter records appears to be linked to the complexity of overland shipment system that Iraq had to develop after its Basra port was closed during the height of the Iran-Iraq war. It appears, based on a review of sample records, that Iraq maintains records to establish proof of arrival for its GSM purchases.

(4) On several occasions during the period 1987-1989, state enterprises of the Government of Iraq appear to have requested "after sales services" from U.S. exporters, either in the form of requests for additional agricultural products, for non-agricultural products (e.g., truck parts or tires), for cash rebates or discounts, or for use of designated Iraqi shipping companies. Iraq has identified several exporters who apparently provided after sales service in response. That information has been turned over to USDA's Office of Inspector General for further investigation. Iraq's Deputy Minister of Trade has provided CCC with a letter confirming that the Government of Iraq has instructed all of its state enterprises not to request or accept after sales services in connection with any future GSM contracts.

(5) Iraq has also requested some exporters to assume responsibility for paying a domestic Iraqi "stamp tax" in connection with GSM transactions. Iraq's Deputy Minister of Trade has confirmed in a letter to CCC that Iraq has changed its policy and will, in the future, specifically exempt GSM transactions from application of this tax.

STATEMENT OF
ROBERT L. CHARAMELLA
VICE PRESIDENT
EXPORT-IMPORT BANK OF THE UNITED STATES
BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES
OCTOBER 16, 1990

Mr. Chairman, Members of the Committee:

I welcome the opportunity to be here today to discuss Banca Nazionale del Lavoro (BNL) and Iraqi participation in Export-Import Bank programs. We at the Bank have carefully reviewed how both parties used Eximbank programs and I am pleased to share our findings with the Committee.

The Bank is, of course, no longer open in Iraq. U.S. exports were banned to Iraq pursuant to Executive Orders dated August 2, 1990 and August 9, 1990 issued by the President. Eximbank's Board of Directors formally withdrew coverage on August 9, 1990.

From July, 1987 to August 2, 1990, Eximbank was open in Iraq for short-term insurance cover only, [up to 360 days] up to a relatively modest aggregate principal exposure limit of \$200 million. We were "off cover" in Iraq for the preceding sixteen months due to payment delinquencies which were paid in full prior to our re-opening that July.

In 1987, we opened cautiously in Iraq only for short term insurance despite tremendous pressure from the American business community as well as competition from foreign Export Credit Agencies who were open for short, medium and long term cover in Iraq. Since 1987, the Government of Iraq has continually requested that we expand our cover to medium term and long term transactions; however, we declined. We never allowed our Iraqi exposure to get out of hand due to the low ceiling set by the Eximbank Board of Directors.

Eximbank's willingness to continue its short term cover in Iraq was based on Iraq's willingness and ability to service its existing debt to the U.S. Government and Eximbank/FCIA in a satisfactory manner.

A clearance mechanism was set up with the Government of Iraq whereby only those transactions cleared by the Iraqi Government by telex notification to Eximbank were eligible for coverage. Payment had to be in the form of an irrevocable letter of credit opened or

guaranteed by the Central Bank of Iraq. Where the Central Bank was the guarantor, either Rafidain Bank or Al-Rasheed Bank could be the opening bank of the letter of credit. Deferred payment terms were permissible up to a maximum of 360 days.

* * *

Now I will provide the Committee with an overview of the Eximbank programs used by Iraq. The programs utilized by Iraq were the Short-term Single Buyer and the Bank Letter of Credit insurance policies.

In general, both insurance policies indemnify the insured party -- the U.S. exporter or U.S. financial institution -- against the risk of non-payment on the part of the Iraqi opening bank of a letter of credit issued in payment for Iraq's purchase of eligible U.S. goods.

The Short-Term Single Buyer Policy was utilized by U.S. exporters (non-financial institutions) and the Bank Letter of Credit insurance policy was utilized by U.S. banks.

If the exporter were the insured, in most cases, they would assign their insurance policy proceeds to the U.S. bank as collateral so as to obtain funding after shipment of the goods and negotiation of the letter of credit. The U.S. bank would then

collect the funds from the Iraqi opening bank at maturity.

If the U.S. bank were the insured, they would issue the beneficiary an irrevocable commitment to pay under the Iraqi letter of credit (silent confirmation) upon presentation of documents as stipulated in the letter of credit. After the credit was negotiated, the U.S. bank would also in this case collect the payment from the Iraqi opening bank at maturity.

In either case, if the Iraqi opening bank did not pay, the insured party could file a claim.

* * *

The current Eximbank exposure in Iraq is \$73.5 million, of which \$55 million is for amounts outstanding and \$18.5 million represents potential exposure.

The potential exposure of \$18.5 million relate to shipments which did not take place before August 2. Since U.S. exports to Iraq were banned as a result of the Executive Order dated August 2, no further shipments are expected to take place -- thus, related Iraqi letters of credit are not expected to be negotiated. Consequently this exposure will be taken off our books.

With regard to claims which Eximbank has paid because of Iraq's failure to pay, we have paid only one small claim of

\$53,300. This was on July 20, 1990 and resulted from the non-payment of some post maturity interest which was disputed by the Iraqi opening bank. Prior to August 2, we were negotiating with the Iraqi bank and were confident that it would be resolved in a satisfactory manner.

It does appear very likely that we will have to pay claims in the near future for the \$55 million of actual exposure which I mentioned previously. How will these claims be treated? These claims will constitute a purchase of assets, which we hope to work out with the Iraqis at some future date.

Mr. Chairman, you asked that I explain BNL participation in Export Import Bank programs -- and, I will do that now. We offer Eximbank programs to financial institutions which are determined to be creditworthy as required by the Export-Import Bank Act of 1945, as amended.

After review of BNL's financial standing and operations abroad and in the U.S., Eximbank programs were made available to the BNL offices in Rome, New York and Atlanta.

The BNL-Rome office acted as guarantor for two medium term transactions in the mid-1970s for an aggregate of approximately \$4 million which was disbursed and repaid in a satisfactory manner.

The U.S. branches of BNL have not used the Eximbank medium term and long term programs.

BNL-New York has used the Eximbank Working Capital Guarantee Program for ten transactions. The latest transaction was approved within the last few days. None of export shipments resulting from a working capital guarantee went to Iraq. The aggregate value of these transactions is \$5.7 million.

BNL-Atlanta received a Bank Letter of Credit policy which was used to insure Iraqi letters of credit, in the manner I described previously. This policy expired on December 31, 1989. BNL was the insured for 51 transactions which aggregated \$47 million - \$43.8 million has been repaid satisfactorily. There is currently \$3.2 million outstanding to BNL which is included in the \$55 million of actual exposure to Iraq and will likely result in a claim.

Those are the results of our review. I would be happy to answer any questions the Committee may have.

United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
9:30 a.m. EDT
Tuesday
October 16, 1990

Report on the Commodity Credit Corporation's
GSM-102/103 Export Credit Guarantee Programs
and Iraq's Participation in the Programs

Statement of
Allan I. Mendelowitz, Director
Trade, Energy, and Finance Issues
National Security and International Affairs
Division

Before the Committee on Banking, Finance and
Urban Affairs
United States House of Representatives



Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the management and operations of the U.S. Department of Agriculture's Commodity Credit Corporation's (CCC) Export Credit Guarantee Program and Intermediate Export Credit Guarantee Program, referred to as the GSM-102 and GSM-103 programs, respectively. The GSM-102/103 programs are managed and operated by the Foreign Agricultural Service (FAS). Besides our overall views on management of the programs, you asked that we specifically address Iraq's participation and some of the issues involved.

In the past few years, we have conducted several reviews of these programs in response to requests from the Senate and House agriculture committees and the House Budget Committee's Task Force on Urgent Fiscal Issues. In general we have found that FAS needs to improve its management controls over the programs to better ensure the programs' integrity and to avoid excessive financial risk to the U.S. government. Regarding Iraq, a number of issues have arisen over its participation--most importantly perhaps, Iraq has stopped repayment on approximately \$2 billion in guaranteed loans. Many of those loans are from one bank, the Atlanta branch of the Banca Nazionale del Lavoro, which has been under investigation for several irregularities.

HOW THE PROGRAMS WORK

The GSM-102/103 programs are U.S. government loan guarantee programs designed to increase exports of U.S. agricultural commodities. The GSM-102 program has been in effect since 1981 and the GSM-103 program has been in effect since 1986. Almost \$33 billion in loan guarantees have been approved to finance U.S. agricultural exports under these programs.

Each year, FAS announces the availability of loan guarantees for credit sales of specified commodities made to buyers in specified countries. Loan guarantees announced for Mexico, Korea, and Iraq are among the highest under the programs. In return for payment of a relatively small guarantee fee, a U.S. exporter obtains a CCC guarantee that he or she will be repaid for a credit sale made to a buyer in an eligible foreign country. If the buyer fails to repay, then the exporter can file a claim with CCC for the loss. After paying the claim, CCC attempts to obtain reimbursement from the foreign buyer or the foreign buyer's government.

Exporters are generally not able to, or interested in, personally financing a sale. Therefore, the programs are designed to allow the exporter to obtain immediate payment on the credit sale by assigning the account receivable and the repayment guarantee to any financial institution in the United States desiring to participate in these programs. When this assignment is made, the financial

institution pays the exporter for the value of the sale and begins collecting the periodic payments from the foreign buyer. If the foreign buyer defaults on a payment, then the financial institution can look to CCC for recovery. CCC must approve the exporter's assignment of guarantees to financial institutions.

CCC generally tries to share some of the financial risk with the exporter, or the exporter's assignee, by not providing 100-percent coverage for a loan's principal and interest. CCC guarantees 98 percent of the value of the sale plus a significant portion of the interest payable. The exporter or the exporter's assignee is at risk for 2 percent of the principal and a portion of the interest payable. However, CCC has flexibility to adjust the amount of guarantee coverage it provides. For example, in the past, CCC has guaranteed 100 percent of the value of commodity sales to Mexico.

There are no operational differences between the GSM-102 program and GSM-103 program; however, each program covers different repayment periods and has different funding authorization levels. Under the GSM-102 program, guarantees are provided for sales having credit terms of 36 months or less. Under the GSM-103 program, guarantees are provided for sales having credit terms of 3 to 10 years. In the 1985 farm bill, Congress directed CCC to make available not less than \$5 billion annually in guarantees under the GSM-102 program and not more than \$1 billion annually under the GSM-103 program.

CCC's contingent liabilities under the programs total about \$8.9 billion as of September 30, 1990. CCC has paid out about \$3 billion in claims since the programs' inception and is at risk for the approximately \$2 billion not being serviced by Iraq.

RESULTS FROM PRIOR GAO REVIEWS

Over the past few years we have reported¹ that the GSM-102/103 programs were not being adequately managed. Specifically, we reported that CCC had not adequately (1) accounted for outstanding guarantees, (2) ensured that guarantees were being used only for U.S. agricultural commodities, (3) provided guidance to GSM-102/103 program users, and (4) reflected estimated program losses in its financial statements. We recommended that the Secretary of Agriculture direct the General Sales Manager, FAS, to do the following:

¹ Status Report on GAO's Reviews of the Targeted Export Assistance Program, the Export Enhancement Program, and the GSM-102/103 Export Credit Guarantee Programs (GAO/T-NSIAD-90-53, June 28, 1990; GAO/T-NSIAD-90-02, Feb. 21, 1990; and GAO/T-NSIAD-90-12, Nov. 16, 1989); Financial Audit: Commodity Credit Corporation's Financial Statements for 1988 and 1987 (GAO/AFMD-89-83, Aug. 1988); Commodity Credit Corporation's Export Credit Guarantee Programs (GAO/T-NSIAD-89-41, June 14, 1989; GAO/T-NSIAD-89-9, Mar. 1, 1989; and GAO/T-NSIAD-89-2, Oct. 6, 1988); International Trade: Commodity Credit Corporation's Export Credit Guarantee Programs (GAO/NSIAD-88-194, June 1988); and International Trade: Commodity Credit Corporation's Refunds of Export Guarantee Fees (GAO/NSIAD-87-185, Aug. 1987).

- Enforce compliance with the requirement that exporters submit complete reports of exports to ensure accurate accounting of outstanding guarantees.
- Design, develop, test, and implement internal controls, including random on-site verifications, to ensure that loan guarantees are only used to obtain U.S. agricultural commodities.
- Clarify program regulations by providing specific definitions of what constitutes a U.S. agricultural commodity and a firm sale and demand acknowledgement of these requirements on guarantee applications.
- Provide timely and accurate decisions on document revisions requested by exporters or their assignees.
- Initiate suspension or debarment actions against program participants found to have violated program regulations.
- Act to prevent less-than-arms-length transactions between participating financial institutions in the United States and in the importing countries.

We also recommended that CCC include an allowance for estimated losses in its financial statements.

Action has been taken on some of our recommendations. For example, CCC has improved its accounting for outstanding loan guarantees, enhanced some internal controls over the programs, and is in the process of recognizing estimated losses in its 1989 financial statements.

However, we believe that further improvements are still needed in tightening internal controls, specifically those related to financial institutions' participation in the programs, and in defining an agricultural commodity eligible for export under the programs.

PARTICIPATION OF FINANCIAL INSTITUTIONS
IN THE GSM PROGRAMS

The success of the GSM-102/103 programs depends greatly on the active participation of financial institutions. These institutions disburse the approximately \$4 billion in GSM loans each year, providing direct credit to the foreign buyers. About 100 financial institutions have participated in the programs since their inception. They make money on this low-risk business by charging fees for advising on letters of credit and by collecting the interest on the credit sales. However, of the 100 or so participating financial institutions, only a few have been major participants and have dominated the lending activity under the programs. Representatives of the banking industry claim that while

the GSM-102/103 loans are very low in risk, they are also very low in profits. We found that the few financial institutions heavily involved in the programs specialize in government loan programs and use their specialization to minimize costs and maximize profits.

Despite the important role played by the institutions, CCC has only two regulations covering their GSM-related activities. The first is that participating institutions must be located in the United States. The second prohibits a participating U.S. financial institution from being affiliated with the overseas bank issuing the letter of credit, which the foreign buyer uses to pay for the commodities exported under the GSM programs.

Although the second regulation prohibits participation in transactions by affiliated banks, it does not fully protect U.S. interests from other less-than-arm's-length relationships. CCC has guaranteed the financing of exports to foreign governments who were also owners of the U.S. institutions lending the money and receiving the GSM guarantees.

During a recent review, we found three U.S.-based financial institutions that were either directly owned by or otherwise affiliated with government-owned banks in GSM customer countries. The three financial institutions had foreign customer ownership ranging from 14 percent to 100 percent of the institution's equity. Since inception of the GSM programs, CCC has guaranteed about \$1.3

billion in these related-party transactions. Although these financial institutions are complying with current regulations, should a default occur, any guarantee payment made by CCC to these U.S.-based institutions would financially benefit the foreign government that is in default. These apparent less-than-arm's-length transactions increase the risk of losses to the U.S. government.

In fact, two of these three financial institutions held guaranteed debt on which their foreign government owners defaulted. One institution is owned by a consortium of several banks and 43.7 percent of its equity is owned by a defaulting government's central and nationalized banks. The other institution is also owned by a foreign consortium and has financed about \$588 million in GSM transactions to one of its owner countries which owns 14 percent of the institution's equity. These loans represent about 62 percent of the institution's total GSM portfolio.

In one of the three cases in which there appear to be less-than-arm's-length relationships, there have been no defaults. This U.S.-based financial institution is a branch of the foreign country's national bank and has financed over \$474 million in commodity exports to its own country under this guaranteed loan protection from the United States.

IRAQ'S PARTICIPATION IN THE GSM-102/103 PROGRAMS

Iraq's participation in the GSM-102/103 programs began in 1983, just before we re-established official diplomatic relations with that country. Iraq was initially allocated \$230 million in loan guarantees under the GSM-102 program to purchase feedgrains, rice, and wheat. The Iraqis were depleting their foreign exchange reserves due to their war with Iran and they desperately needed credit. In 1984 Iraq's allocation was almost tripled, to about \$680 million. Iraq began importing protein concentrates, tobacco, vegetable seeds, and other commodities in addition to the feedgrains, rice, and wheat. By 1988 Iraq's GSM-102/103 allocations totaled about \$1.1 billion and were used to purchase some 30 different commodities. This level of GSM-102/103 allocations continued in 1989 and the Iraqis sought the same levels in 1990. However, when the unauthorized loans involving Iraq came to light in the Banca Nazionale del Lavoro case, the Agriculture Department decided to scale back the 1990 program for Iraq to \$500 million, with the possibility of another \$500 million allocation pending results of Justice's investigation of the bank.

In the meantime, the Agriculture Department began conducting its own review of Iraq's participation in the GSM-102 program. In May 1990, the Department concluded that certain exporters to Iraq had been charging high prices and providing Iraq "after-sales services" which, in the Department's view, may have violated program

regulations. The Department plans further inquiry into these potential violations at the conclusion of the Banca Nazionale del Lavoro investigation, when more information becomes available.

Problems identified in the GSM programs for Iraq so far include the following:

- Iraq has suspended payment on its approximately \$2 billion in outstanding GSM guaranteed loans, exposing CCC to a substantial loss.
- One bank, the Banca Nazionale del Lavoro, has a high concentration of loans to Iraq, a significant amount of which are guaranteed under the GSM programs. However, most of the GSM guaranteed loans were not authorized by higher level bank officials. I'll discuss this in more detail later in this statement.
- Foreign origin agricultural commodities have been exported to Iraq under the GSM programs. Such exports are contrary to program regulations which state that the guarantees are to be provided for U.S. agricultural commodities. Eight tobacco exporting companies have pleaded guilty to shipping foreign tobacco to Iraq or Egypt under the programs and have been fined a total of \$300,000. The companies were also directed to pay

restitution costs to CCC of up to \$1.1 million should CCC incur losses related to those shipments.

-- Money obtained under Iraqi participation in the GSM programs has been used for purposes other than those permitted, including after-sales services that are unrelated to agricultural exports.

BANCA NAZIONALE DEL LAVORO
INVESTIGATION CONTINUES

In previous testimony, we reported that the Department of Justice was investigating allegations that Banca Nazionale del Lavoro's Atlanta, Georgia, branch made more than \$2 billion in loans to Iraq, of which only a fraction had been authorized by higher-level bank officials. Some of these loans, amounting to approximately \$750 million, were guaranteed under the GSM programs and, of that amount, only about \$130 million had been authorized. The investigation is still ongoing, and none of the related information has been made available.

Banca Nazionale del Lavoro is Italy's largest state-owned bank. Headquartered in Rome, it has several branches operating in the United States. The New York City branch is responsible for North American operations, and its Atlanta, Georgia, branch has provided the GSM loans.

There may be lessons to be learned from the Banca Nazionale del Lavoro investigation. Once it is complete, we plan to evaluate the extent to which individual financial institutions participate in GSM programs. We will also assess the potential impact that such participation may have on CCC's guarantee liability. In particular, we will review the bank's involvement with Iraq and determine the appropriateness of allowing one bank to participate to such a large extent in the GSM programs, especially if that bank's loan exposure is concentrated in a single country.

Our work in this area is continuing at the request of Chairman Charlie Rose of the Subcommittee on Tobacco and Peanuts, House Committee on Agriculture and Congressman Charles Schumer. Investigations by the Department of Justice and U.S. Customs Service on these issues are also continuing.

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Mr. Chairman and members of the Committee, this concludes my statement. I will be happy to answer any questions you may have.

APPENDIX I

APPENDIX I

TOTAL GSM-102 PROGRAM GUARANTEES
MADE AVAILABLE AND APPROVED
(Dollars in Millions)

<u>Fiscal</u> <u>year</u>	<u>Guarantees made</u> <u>available</u>	<u>Guarantees</u> <u>approved</u>
1981	\$2,189.1	\$2,082.1
1982	3,224.6	1,543.3
1983	4,079.9	3,709.3
1984	4,125.6	3,431.2
1985	4,485.2	2,512.8
1986	4,175.3	2,522.4
1987	3,821.4	2,622.5
1988	4,792.0	4,141.4
1989	4,965.2	4,769.8
1990	4,610.7 ^a	3,957.4 ^a
Total	<u>\$40,469.0</u>	<u>\$31,292.2</u>

^aTentative figures as of October 11, 1990.

Source: GSM-102 Commitment Reports prepared by the U.S. Department of Agriculture's (USDA) Foreign Agricultural Service, CCC Operations Division.

APPENDIX II

APPENDIX II

TOTAL GUARANTEES MADE AVAILABLE AND
APPROVED FOR THE GSM-103 PROGRAM
(Dollars in Millions)

<u>Fiscal</u> <u>year</u>	<u>Guarantees made</u> <u>available</u>	<u>Guarantees</u> <u>approved</u>
1986	\$377.0	12.7
1987	410.9	250.4
1988	504.4	362.9
1989	485.3	425.5
1990	<u>468.3^a</u>	<u>332.1^a</u>
Total	<u>\$2,245.9</u>	<u>\$1,383.6</u>

^aTentative figures as of October 11, 1990.

Source: GSM-103 Commitment Reports prepared by USDA's Foreign Agricultural Service, CCC Operations Division.

APPENDIX III

APPENDIX III

CCC'S CONTINGENT LIABILITY
UNDER THE GSM-102/103 PROGRAMS FOR IRAQ
 (By Fiscal Year)

<u>Fiscal year</u>	<u>Contingent liability</u>
1990	\$154,336,744
1991	930,144,855
1992	622,021,012
1993	287,593,955
1994	6,971,205
1995	3,817,090
1996	3,593,898
1997	<u>121,227</u>
Total	<u>\$2,008,599,986</u>

Source: USDA's Foreign Agricultural Service, Financial Management Division.

TESTIMONY OF
PIETRO LOMBARDI
EXECUTIVE VICE PRESIDENT AND
REGIONAL MANAGER FOR NORTH AMERICA
OF
BANCA NAZIONALE DEL LAVORO ("BNL")
ON
ACTIVITIES OF THE ATLANTA AGENCY OF BNL
BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES
9:30 A.M.
OCTOBER 16, 1990
ROOM 2128, RAYBURN HOUSE OFFICE BUILDING

Good morning, Mr. Chairman and members of the Committee. My name is Pietro Lombardi and I am the Executive Vice President and Regional Manager for North America of Banca Nazionale del Lavoro ("BNL"). At your request, I am here to respond to the questions raised in the Chairman's letter to me dated September 25, 1990.

At the outset, I should note that I was transferred from the Rome headquarters to the regional headquarters of BNL in New York shortly before the so-called "Atlanta affair" was uncovered in August 1989 and that my personal knowledge of this matter is largely based on what I have been told since that time by others who are involved in investigating the affair, not by those who were directly involved in what happened.

As you know, these transactions are still being investigated by the Departments of Justice and Agriculture and several regulatory agencies both state and federal. In addition, a federal grand jury was convened in Georgia in August 1989 to investigate this matter. The Justice Department has notified BNL that it is not a target of that investigation. BNL has been actively cooperating with all of these investigations. Moreover, BNL has filed a civil lawsuit in federal district court in Georgia against two former officers of the Atlanta agency in connection with these

transactions (Banca Nazionale del Lavoro v. Christopher Drogoul and Paul Von Wedel). Due to the criminal investigations, however, all discovery in that lawsuit has been stayed by the federal court. BNL does not want to make any statement or take any action which would prejudice these legal proceedings or impair the prospects of having the responsible persons brought to justice.

By way of background, BNL is the largest commercial bank in Italy in terms of deposits. As of December 31, 1989, the Italian Ministry of the Treasury and other entities controlled by the Italian Government owned approximately 96% of BNL's shares. BNL operates in the United States through its offices in New York, Chicago, Los Angeles, Miami, and Atlanta.

Turning to the questions you have raised, I know that your staff in a public hearing has summarized the general scheme that was used by former employees of the Atlanta agency to victimize the bank. In addition, of course, the complaint filed by BNL in connection with the lawsuit in federal court referred to above has been submitted to the Committee's staff, and I ask that it be included as part of my testimony.

On August 4, 1989, BNL representatives in Rome and New York were informed by various agencies of the U.S. Government that BNL's Atlanta agency had provided various types of

unauthorized financing -- unauthorized by BNL but not in contravention of U.S. law or policy -- to Iraqi Government entities. This news stunned BNL, because of the amounts involved and the uncertainty of the consequences. In order to have successfully hidden these transactions from BNL and the regulators, several persons in the Atlanta agency must have been involved. In order to discover the true size and nature of these transactions, a comprehensive attempt to reconstruct them was undertaken by BNL.

In general, these unauthorized transactions -- unauthorized by BNL but not illegal or in any way inconsistent with the policy of the United States -- consisted principally of:

One -- extending credit facilities to certain Iraqi Government entities and other private entities in Iraq, and

Two -- participating in the Agriculture Department's Commodity Credit Corporation ("CCC") programs with respect to Iraq and other countries in excess of levels approved by BNL.

Insofar as Point One is concerned, neither the U.S. Government or the U.S. banking system has lost or will lose any money as a result of these transactions. Moreover, no American has lost or will lose any money as a result of these

transactions. Neither BNL's Atlanta agency or any other U.S. office of BNL is insured by the U.S. Government. Accordingly, the Federal Deposit Insurance Corporation will not incur any liability for any of these transactions. Liabilities in connection with these transactions have been assumed by BNL in Rome. Although at this time BNL is at risk, the extent of the loss is still unclear.

The basic point to be made is that BNL was the victim of the actions of the former officers and employees in Atlanta. We believe that these individuals acted on their own to make these unauthorized transactions and then engaged in clandestine efforts to deceive BNL and others about their existence. As a result, BNL's reputation has suffered and it is at risk on the money owed to it by Iraq. Thus, although these credits were made through the Atlanta agency without BNL's approval, they are now considered to be loans extended by BNL in Rome for which BNL is obligated.

I would now like to turn to Point Two, that is the CCC loans. Insofar as the CCC loans are concerned, although these loans exceeded internal limits sanctioned by BNL, they were not illegal or contrary to U.S. law or policy towards Iraq in effect at the time. In particular, the Atlanta agency's participation in the CCC programs was in accordance with CCC rules and regulations with respect to all of the countries

involved, including Iraq. In fact, the U.S. Government authorized these programs for the benefit of American farmers and exporters of agricultural commodities and intended that financial institutions would participate in them.

In this regard, I would also like to note that several other financial institutions in the United States participated in the CCC programs for Iraq. The record shows, for example, that major American banks participated in these programs. Further, of the current \$2 billion of authorized CCC guarantees involving Iraq, BNL holds only \$382 million (less than 20% of the total).

Thus, although the Atlanta agency exceeded internal limits for participating in the CCC programs, its participation was legal and entirely consistent with the policy of the CCC which prevailed at the time. BNL's participation did not increase or affect the amount of approved CCC exposure. In fact, the CCC programs for Iraq continued after August 1989 through the participation of other banks.

During the period in question, BNL's Atlanta agency was subject to regular and customary annual examinations by the Federal Reserve Bank of Atlanta and the Georgia Department of Banking and Finance. The external auditors, Peat Marwick, also conducted annual audits and examinations.

The BNL system of internal controls in effect prior to August 1989 only detected operational problems and did not anticipate the extraordinary circumstances and activities that occurred in the Atlanta agency. In spite of internal and external controls, however, the responsible individuals in the Atlanta agency were able to avoid detection. This, of course, is regrettable. No one regrets this more than BNL because it is the victim of the deception and will lose money from it.

BNL has since implemented a wide variety of actions to protect against a reoccurrence of such misconduct. While we are continuing to work with the bank regulators on this subject, the new controls and procedures include a more rigorous audit program; concentrating funding and foreign exchange operations in the New York branch, which is now the BNL treasury center for the United States; instituting stricter credit limits; requiring all BNL offices to use the same computer system in order to permit constant regional management supervision; and rotating experienced BNL employees through each BNL office. We believe that these new controls will effectively guard against such misconduct in the future.

In this regard, I should also note that since BNL was made aware of this matter, it has devoted significant resources and personnel to the matter. Also, BNL has cooperated fully with all of the U.S. and Italian investigations, and it

continues to do so. In response to one of your questions, Mr. Chairman, BNL has not been asked by the Federal Reserve or any other bank regulatory agency to sign a supervisory agreement in this regard.

In Italy, the Atlanta affair has been the subject of a number of investigations. The Bank of Italy, which monitors BNL's activities, has examined this affair. I also understand that an Italian Magistrate in Rome is conducting an investigation regarding possible criminal proceedings. In addition, the Italian Senate has appointed a commission of inquiry to investigate the matter.

Since BNL is owned by the Italian Government, this matter and its economic consequences, as you can appreciate, continue to be of significant concern to the Italian Government. Italy and BNL are, of course, abiding by the economic sanctions imposed against Iraq.

Regarding the question in the Chairman's letter addressed to me about whether the regulatory structure governing the activities of foreign banks in the United States was responsible for this affair, let me say that we believe that the Atlanta affair was due primarily to the collective efforts of a group of former employees who circumvented existing internal controls and procedures which in retrospect were

inadequate to deal with the unique circumstances that existed in this case. After all the facts are fully developed by the investigations underway, a more complete picture on questions of responsibility will emerge.

Let me conclude by saying that neither the American Government or any individual American has lost or will lose any money as a result of what happened at the Atlanta agency of BNL. BNL is the victim of what happened at its Atlanta agency. So, Mr. Chairman, as the victim of this whole affair, we support the work of this Committee, and we will continue to cooperate fully with the American authorities.

Thank you for your consideration.

Testimony by

H. Terry Smith

Senior Vice President, Federal Reserve Bank of Atlanta

before the

Committee on Banking, Finance, and Urban Affairs

U.S. House of Representatives

October 16, 1990

FEDERAL RESERVE BANK OF ATLANTA TESTIMONY

re:

BANCA NAZIONALE DEL LAVORO

INTRODUCTION

Mr. Chairman and members of the House Banking Committee, I am pleased to appear today to discuss with you the role played by the Federal Reserve Bank of Atlanta in the recent events at the Atlanta agency of Banca Nazionale del Lavoro, otherwise known as BNL Atlanta.

My remarks address three areas. First, I will briefly describe the Federal Reserve's supervisory activities with respect to foreign banks in the United States, and in more detail with regard to BNL Atlanta. Second, I will discuss how the Federal Reserve learned about the concealed transactions at BNL Atlanta and will explain the results of the Federal Reserve's examination of BNL Atlanta. Third, I will discuss what has transpired since the examination.

By way of preface to my discussion, let me state that my remarks are necessarily limited due to the investigation by the United States Attorney's office in Atlanta. The Federal Reserve has provided assistance to the U.S. Attorney since the discovery

of the problems at BNL Atlanta. This assistance has taken the form of assigning an examiner to the U.S. Attorney's office and working with the U.S. Attorney in every way possible. We have been active in deciphering bank documents and in tracking bank and trade transactions. However, I am not personally privy to the evidence that has been developed by the U.S. Attorney's office. The examiner assigned to this effort has devoted a majority of his time since the discovery of the problems at BNL Atlanta to the U.S. Attorney's office. He is subject to the confidentiality requirements of the U.S. Attorney's office and thus has not been able to share with us the results of his work there. Responses to the seven specific questions of the Committee are contained in Appendix A.

I. FEDERAL RESERVE'S ROLE IN THE SUPERVISION OF FOREIGN BANKS

With the passage of the International Banking Act of 1978, Congress established a framework for federal regulation and supervision of foreign banking organizations (FBOs) operating in the United States. Prior to the passage of the Act, there was no federal supervision of agencies and branches of foreign banks active in the U.S. banking market. The Act left primary examination authority with the licensing entities, the states and the Office of the Comptroller of the Currency; however, it gave the Board of Governors oversight responsibility for foreign banks operating in the U.S. This oversight responsibility included

residual examination authority.

The Federal Reserve Board's policy on the supervision of agencies and branches of foreign banks is given in a joint statement adopted by the Federal Financial Institutions Examination Council on July 20, 1979. The policy emphasizes the importance of coordination and cooperation among the regulatory agencies and describes the development of universal examination standards and uniform reporting requirements for foreign banks operating in the U.S.

The Board's supervisory responsibility for foreign banking organizations centers on an analysis of parent organization finances and on the examination reports of U.S. subsidiaries or of branches and agencies of foreign banks. The International Banking Act specifies that the Board is to rely on the reports of the primary regulator whenever possible.

In response to the mandate of the International Banking Act, the Board developed a supervisory program in which each foreign bank operating in the U.S. is assigned to a Reserve Bank ("the responsible Reserve Bank"). This Reserve Bank is responsible for evaluating the consolidated condition of each foreign banking organization assigned to it.

The Federal Reserve Bank of Atlanta is currently responsible for evaluating 14 foreign banking organizations, all of which are

headquartered in Latin America. The Reserve Bank determines the strength of the foreign banking organization by analyzing yearly reports of condition filed with the Board of Governors, conducting annual visitations with U.S. management, and maintaining periodic contact with senior home country management and bank supervisors. The analysis also includes a review of the condition of U.S. branches, agencies and subsidiaries. This information is gathered through an analysis of the most recent examination reports and discussions with the primary regulator.

Banca Nazionale del Lavoro (BNL) operates several offices in the United States. The Federal Reserve Bank of New York is the responsible Reserve Bank for BNL; that is, it is the Reserve Bank charged with overseeing BNL's U.S. operations. This responsibility, as previously stated, includes an annual review of parent strength and the condition of each U.S. subsidiary, branch, and agency. The Federal Reserve Bank of Atlanta assists the Federal Reserve Bank of New York in fulfilling its supervisory responsibility by ensuring that all offices of BNL in the Sixth Federal Reserve District (the Southeast) are examined on a timely basis, as required by the International Banking Act. Banca Nazionale del Lavoro's Atlanta agency was examined by its primary regulator, the State of Georgia, Department of Banking and Finance, on a regular basis, with occasional assistance from examiners of the Federal Reserve Bank of Atlanta.

Georgia and Florida are the only states in the Sixth Federal

Reserve District with active foreign agencies. There are 66 agencies in the District; 23 in Georgia and 43 in Florida. Agencies in Georgia are all units of prominent European, Japanese and Canadian banks and, under Georgia law, are not permitted to take deposits, except for International Banking Facility (IBF) deposits which are subject to a number of restrictions. Of the 43 agencies in Florida, 16 are of banks from countries experiencing economic and/or political problems which could affect debt service. Florida agencies have broader deposit taking abilities than Georgia agencies. Thus, our enhanced examination program, begun in 1988, focused our resources on Florida agencies of relatively weaker parent banks.

Our enhanced examination program for agencies has expanded each year as we have directed resources to the international area. We now have an informal alternate examination program with the State of Georgia begun partially because of BNL, and are working toward a similar program with the State of Florida. This program allows us to assist the states in fulfilling their examination responsibilities and provides us with direct exposure to the institutions.

Examination History of BNL Atlanta

The BNL agency in Atlanta is licensed by the State of Georgia and opened for business as an agency on May 20, 1982. The agency has been examined annually since 1983 by the State's

Department of Banking and Finance. The Federal Reserve Bank of Atlanta's participation in each examination was generally limited to a review of compliance with various federal laws and regulations. This compliance review encompassed a check of the operations of the agency's International Banking Facility (IBF) and reports filed with the Reserve Bank, including the F.R. 2900 - Report of Transaction Accounts, Other Deposits and Vault Cash, the F.R. 2951 - Report of Certain Eurocurrency Transactions, and the FFIEC 002 - Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks. Examiners occasionally assisted in loan reviews as requested by the State. State examiners were responsible for issuing the Report of Examination, which was then forwarded through the Atlanta Reserve Bank to the Board of Governors and the Federal Reserve Bank of New York, the responsible Reserve Bank.

II. RESERVE BANK'S 1989 EXAMINATION

The Reserve Bank became aware of the possibility of concealed transactions at BNL-Atlanta on July 28, 1989, when contacted by the U.S. Attorney's office in Atlanta. The Board of Governors and the responsible Reserve Bank, the Federal Reserve Bank of New York, were immediately informed of the information we had. Officials of the New York Reserve Bank were dispatched to Atlanta to discuss the matter and to assess the risk. Senior officials of the Board of Governors and the New York Reserve Bank

flew to Rome to inform officials of BNL and the Bank of Italy of the situation. The timing of the notifications and the Reserve Bank's actions were coordinated with officials of several federal agencies.

On August 4, 1989, the Federal Reserve Bank of Atlanta commenced a surprise examination of BNL Atlanta, accompanied by Federal Bureau of Investigation agents in order to secure files, other documents, and computer disks that might reflect concealed transactions. The Reserve Bank sent in ten examiners and officials.

Simultaneously, a full scope examination was also commenced at each BNL office in the United States. The examinations, which were coordinated through the Federal Reserve Board, were conducted by examiners of the Atlanta, Chicago, New York, and San Francisco Reserve Banks -- at BNL offices in Atlanta and Miami, Chicago, New York and Los Angeles. The examinations focused on determining the extent of concealed transactions at all BNL offices in the United States, the reasons behind any concealed transactions, the possibility of violations of Federal laws and regulations, and the level of BNL's exposure.

Reserve Bank examiners at BNL Atlanta also worked with their counterparts from the State of Georgia. The Bank of Italy, the Italian Central Bank and primary supervisory agency of the parent bank in Rome, also sent a team of inspectors to Atlanta who

conducted an independent review.

No concealed transactions were found at the other BNL offices. Reserve Bank examiners confirmed the existence of concealed transactions at BNL Atlanta. The failure to report these transactions resulted in the material misstatement of BNL Atlanta's periodic reports to the Federal Reserve.

Loans to Iraq

Our examination revealed a total of \$1.865 billion in loans outstanding to Iraq and an additional \$1.2 billion in commitments to lend to the Central Bank of Iraq. Only \$67 million of this amount had been reported to the Federal Reserve. BNL Atlanta had failed to report \$1 billion in outstanding loans to the Central Bank of Iraq, \$800 million in outstanding loans to Rafidain Bank of Iraq, and \$1.2 billion in commitments to lend to the Central Bank of Iraq. BNL Atlanta also failed to report \$1.8 billion in monies borrowed in the world money markets to support its concealed loans.

According to BNL officials, the concealed transactions were made without authorization from BNL headquarters in Rome. These transactions far exceeded BNL Atlanta's lending limit to Iraq, which was \$100 million on a secured or guaranteed basis. Lending to Rafidain Bank, a commercial bank owned by the Iraqi government, dated from late 1986, and consisted largely of

agricultural loans guaranteed under the U.S. Department of Agriculture's Commodity Credit Corporation program. From mid-1987 until August 1989, outstanding balances on these credits averaged approximately \$800 million. The lending to the Central Bank of Iraq started in February 1988 with an agreement to provide the Central Bank of Iraq with \$200 million in loans with principal due in 1993. Subsequent agreements during 1988 and 1989 raised the total commitments to lend to \$2.2 billion.

The loan commitments to the Central Bank of Iraq were designed ostensibly to provide medium-term financing for Iraq's industrialization program. The loans from BNL Atlanta would finance the purchase of goods including manufactured items and machinery. However, during the August 4 examination, it was discovered that some of the letters of credit did not specify the goods being financed. And, during a brief period in 1989, BNL Atlanta sent the Central Bank of Iraq \$107 million without supporting trade documents.

Computer records of the Iraqi transactions were maintained on a separate system from BNL Atlanta's authorized operations. Hard copy records of concealed transactions were maintained in boxes and moved back and forth from employees' homes and cars to the office as needed. Employees would remove all boxes and computer records from the office before audits and examinations. A majority of work on the transactions, particularly funding operations, was conducted from employees' homes. These

transactions were not included in reports filed with the Federal Reserve.

III. ACTIVITIES SINCE THE EXAMINATION

BNL installed a new management team at the Atlanta office the day after the commencement of the August 4, 1989 examination. The officers of BNL Atlanta who participated in the off-book transactions were suspended and dismissed. BNL Atlanta's money market operation was closed and the letter of credit operation in Atlanta was placed under the close on-site scrutiny of officials from BNL Rome and New York who came to Atlanta. BNL has to a large extent reconstructed the books of the Atlanta office as of December 31, 1989, and has received a qualified opinion on the books of the Atlanta office from its outside accountant. At the end of 1989, BNL made a loan loss provision for its less developed country exposure including Iraqi debt, raising its reserve for the LDC debt including Iraq to about 60 percent.

The Atlanta Reserve Bank continues to extend considerable resources to act as technical advisors to the various U.S. agencies interested in BNL-Atlanta.

Federal Reserve's Supervisory Action

To date, BNL has not been asked to enter into any formal

supervisory action with the Federal Reserve. The parameters of any supervisory action depend to a significant extent on the involvement of BNL officials regarding the activities of the Atlanta agency, which is a matter related to the criminal investigation. In order to avoid interfering with that process, the Federal Reserve System has deferred a final decision on this matter.

The Federal Reserve has, however, through the supervisory process, ensured that BNL has taken appropriate action to correct the situation at the Atlanta agency. BNL has promptly and voluntarily instituted remedial actions requested by the Federal Reserve, including verifying the off-book transactions, preparing and filing accurate reports, and strengthening internal controls. As indicated, BNL also replaced the management and personnel of the Atlanta agency. We have and will continue to closely monitor the corrective action instituted by BNL.

Federal Reserve's Examination Program

As discussed previously, the Federal Reserve Bank of Atlanta began enhancing its role in agency examinations in mid-1988. Initially, our resources were concentrated on agencies with weaker parent banks. Given the differing composition of agency constituency in Florida and Georgia, the first independent examinations conducted were of Florida agencies. An informal alternate examination program with the State of Georgia was

adopted in 1990 partially because of BNL, and we are working toward a similar program with the State of Florida.

SUMMARY

In summary, Mr. Chairman, after we were informed by the Assistant U. S. Attorney of possible irregularities at BNL-Atlanta, the Federal Reserve moved quickly to identify and contain the problem. Only one week after disclosure of the irregularities, simultaneous surprise examinations were commenced at each office of BNL in the United States, coordinated among four Reserve Banks and the Board of Governors. Senior officials from the Federal Reserve Bank of New York and the Board of Governors were in Rome to personally inform BNL and the Bank of Italy. The problem was contained and new management installed. Since the events of August 4, 1989, support has been extended to various agencies of the United States to provide technical assistance for their investigations.

APPENDIX A

Responses to the Questions of the House Committee on
Banking, Finance and Urban Affairs

October 16, 1990

- 1) Explain the Federal Reserve Bank of Atlanta's role in regulating the U.S. operations of BNL-Atlanta.

The International Banking Act of 1978 developed a framework for federal supervision and regulation of agencies, branches and subsidiaries of foreign banks operating in the U.S. Prior to the passage of the Act, there was no federal supervision of branches and agencies of foreign banks operating in the United States. The Act left primary examination responsibility with the chartering/licensing entities, the states or the Office of the Comptroller of the Currency; however, it gave the Board of Governors oversight responsibilities for foreign banks operating in the U.S. This oversight responsibility includes residual examination authority.

The Board of Governors, in its role as supervisor for foreign banks operating in the U.S., developed a supervisory program in which each foreign banking organization is assigned to a Reserve Bank. This Reserve Bank is responsible for monitoring the condition of U.S. offices of the foreign banks it is assigned and doing an annual analysis of parent bank condition. The

International Banking Act directed the Board of Governors to use the reports of other regulators whenever possible in determining the condition of U.S. offices.

The responsible Reserve Bank for BNL is the Federal Reserve Bank of New York. The Federal Reserve Bank of Atlanta assists the Federal Reserve Bank of New York in fulfilling its supervisory responsibilities with regard to BNL by ensuring that all offices of BNL in the Sixth District are examined on a timely basis, as required by the International Banking Act. The State of Georgia has examined BNL-Atlanta regularly since its opening as an agency in 1982. The Federal Reserve Bank of Atlanta occasionally assisted the State in its examinations.

What type of oversight did the Federal Reserve Board conduct of BNL-Atlanta operations over the past five years?

The Federal Reserve Bank of Atlanta's role in overseeing the operations of BNL-Atlanta, prior to the discovery of the concealed transactions, was limited to a review of BNL's compliance with federal laws and regulations. This review encompassed a check of the operations of the agency's International Banking Facility and of reports filed with the Reserve Bank, including the FR 2900-Report of Transactions Accounts, Other Deposits and Vault Cash, the F.R. 2951-Report of Certain Eurocurrency Transactions, and the FFIEC 002-Report of Assets and Liabilities of U.S. Branches and Agencies. Examiners discussed each report with the appropriate personnel and discussed applicable laws, including the Bank Secrecy

Act, with the manager of the agency. Compliance reviews were generally conducted when the State of Georgia's examination was in process. Examiners occasionally assisted in loan reviews at the State's request. The Federal Reserve Bank of Atlanta was responsible for forwarding the State of Georgia's examination report to the Board of Governors and the Federal Reserve Bank of New York.

2) How often did the Federal Reserve examine BNL-Atlanta operations?

The Federal Reserve Bank of Atlanta conducted its first examination of BNL-Atlanta as of August 4, 1989. Prior to August 4, the Federal Reserve Bank of Atlanta had relied on the examinations of BNL-Atlanta's primary regulator, the State of Georgia, Department of Banking and Finance, as directed by the International Banking Act. The Atlanta Reserve Bank did conduct annual compliance reviews of the agency and occasionally assisted in the State's review of loans.

Did BNL sign a supervisory agreement with the Federal Reserve Bank of Atlanta? Why or why not?

To date, BNL has not been asked to enter into any formal supervisory agreement with the Federal Reserve. The parameters of any supervisory action depend to a significant extent on the involvement of BNL officials regarding the activities of the Atlanta agency, which is a matter related to the criminal

investigation. In order to avoid interfering with that process, the Federal Reserve System has deferred a final decision on this matter.

The Federal Reserve has, however, through the supervisory process, ensured that BNL has taken appropriate action to correct the situation at the Atlanta agency. BNL has promptly and voluntarily instituted remedial actions requested by the Federal Reserve, including verifying the off-book transactions, preparing and filing accurate reports, and strengthening internal controls. As indicated, BNL also replaced the management and personnel of the Atlanta agency. We have and will continue to closely monitor the corrective action instituted by BNL.

Are you confident that BNL has corrected the problems that led to this scandal?

Immediately after the August 4, 1989 examination, BNL moved swiftly to correct and contain the problems at its office in Atlanta. A new management team was installed and the situation stabilized within a week of the start of examination. BNL has continued to cooperate with authorities investigating the concealed transactions and continues to expend considerable time and effort in resolving the situation. BNL has reconstructed its books and has received a qualified opinion from its external auditors. Based on a review of BNL's response to our August 4, 1989 Examination, continued contact with BNL management and discussions with external auditors, it appears that weaknesses have been addressed. We will

be better able to comment on conditions at the agency when we complete our current examination, begun October 9, 1990, according to a schedule set some time ago.

3) In regulating the branches and agencies of foreign banks, please explain the coordination that is supposed to occur between the State of Georgia and the Federal Reserve Bank of Atlanta.

The joint policy statement on the supervision of U.S. branches and agencies of foreign banks, issued July 20, 1979, by the Board of Governors, the FDIC and the OCC, and adopted by the FFIEC, describes the coordination of efforts between the federal supervisory agencies and the states. The agencies are charged with ensuring that each office of a foreign bank is examined regularly. The International Banking Act instructed the Board to use the reports of state regulators whenever possible.

The State of Georgia fulfilled its duty as primary regulator by examining agencies on an annual basis and forwarding its reports to the Federal Reserve Bank of Atlanta. The Federal Reserve Bank of Atlanta forwarded said reports on to the Board and the responsible Reserve Bank for use in fulfilling the Board's oversight responsibilities. Examiners for the State of Georgia notified us in advance of each examination of BNL and we conducted our compliance check during Georgia's examination and provided occasional assistance to the State if requested. We have now arranged an alternate year examination program with the State of Georgia.

4) Please provide data on the number of branches and agencies of foreign banks supervised by the Federal Reserve Bank of Atlanta, including balance sheet and income statement data.

There are 66 agencies of foreign banks operating in the Sixth District. Foreign branches are not allowed under state laws in the District. Appendix B contains a list of each agency and its total assets as of December 31, 1989. Agencies of foreign banks are not required to submit income statement data to the Federal Reserve Board.

5) Does the State of Georgia exercise adequate supervision over the activities of U.S. branches and agencies of foreign banks?

Our experience with the State, which encompasses examinations of state member banks and holding companies, as well as examinations of agencies of foreign banks, has demonstrated that the State is a competent and capable supervisor. It appears that the State complied with the instructions for examinations of foreign bank agencies provided by the FFIEC and conducted a professional examination. The situation at BNL-Atlanta was an aberration and escaped detection despite the application of specified examination procedures because of widespread concealment in which key employees participated.

6) Is the regulatory structure governing the U.S. branches and agencies of foreign banks adequate or is the fragmented structure that now exists (i.e., the regulation and examination of these entities is divided among the OCC, FDIC, and Federal Reserve as well as the 50 States) prone to breakdowns such as the one that occurred in the BNL Atlanta case?

This question will be answered in the Board of Governors' testimony.

7) Do you have any recommendations for improving or streamlining the regulation and examination of these entities? Do you have any suggestions for improving coordination between the state banking agencies and the federal bank regulatory agencies?

This question will be answered in the Board of Governors' testimony.

APPENDIX B

Total Assets

of

Foreign Bank Agencies

In the Sixth District

as of

December 31, 1989

INTERNATIONAL BANK AGENCIES IN THE SIXTH DISTRICT*

<u>Florida Agencies</u>	<u>Total Assets**</u>
Algemene Bank Nederland, N.V.	\$ 303,517
American Express Bank Ltd.	28,249
Atlantic Security Bank	116,633
Banca Nazionale del Lavoro	244,429
Banco Atlantico, S.A.	184,503
Banco Bilbao Vizcaya (Miami)	227,197
Banco Central, S.A.	63,803
Banco de la Nacion Argentina	110,681
Banco del Pichincha International	97,081
Banco do Brasil, S.A.	162,372
Banco do Estado de Sao Paulo	239,121
Banco Espanol de Credito, S.A.	75,319
Banco Exterior de Espana	206,243
Banco Ganadero, S.A.	157,151
Banco Industrial de Venezuela	48,439
Banco Internacional de Costa Rica	207,217
Banco Mercantil C.A.	373,876
Banco Mercantil (Coral Gables)	0
Banco Nacional, S.A.	137,190
Banco Popular de Puerto Rico	228
Banco Portugues do Atlantico	47,171
Banco Real, S.A.	165,435
Banco Santander, S.A.	4,257
Bank Hapoalim, B.M.	150,673
Bank Leumi le-Israel, B.M.	317,698
Bank of Credit and Commerce (Miami)	368,658
Banque Nationale de Paris	125,365
Banque Sudameris	720,138
Barclays Bank PLC	943,644
Credit Lyonnais	72,737
Credit Suisse	285,781
Deutsch-Sudamerikanische Bank	1,272,909
Extebandes	99,387
Israel Discount Bank Limited	211,812
Lloyds Bank PLC	404,261
Standard Chartered Bank	77,023
Swiss Bank Corporation	317,698
The Bank of Tokyo, Ltd.	297,988
The Royal Bank of Canada (Miami)	641,243
Verins-und Westbank AG	601,636
Total Florida Assets:	10,108,763

* Information as of 12/31/89 (in Thousands). Income statement data for foreign bank agencies is not collected by the Federal Reserve System.

** Agencies with no assets operate as Representative Offices only.

INTERNATIONAL BANK AGENCIES IN THE SIXTH DISTRICT*

(continued)

<u>Georgia Agencies</u>	<u>Total Assets**</u>
Algemene Bank Nederland, N.V.	148,447
Banca Nazionale Del Lavoro	2,420,919
Barclays Bank PLC	0
Bayerische Vereinsbank AG	19,279
Canadian Imperial Bank of Commerce	401,084
Commerzbank Aktiengesellschaft	174,027
Credit Lyonnais	0
Credit Suisse	0
Creditanstalt-Bankverein	0
DG BANK-Deutsche Genossenschaftsbank	6,201
Kredietbank, N.V.	0
National Bank of Canada	0
National Westminster Bank PLC	0
Nederlandsche Middenstandsbank NV	0
Standard Chartered Bank	121,447
Swiss Bank Corporation	167,158
The Bank of Nova Scotia	1,731,653
The Dai-Ichi Kangyo Bank, Limited	258,836
The Daiwa Bank, Limited	0
The Fuji Bank, Limited	236,089
The Royal Bank of Canada	0
The Sanwa Bank, Limited	761,570
The Sumitomo Bank, Limited	293,664
The Tokai Bank, Limited	0
Total Georgia Assets:	\$6,740,374

* Information as of 12/31/89 (in Thousands). Income statement data for foreign bank agencies is not collected by the Federal Reserve System.

** Agencies with no assets operate as Representative Offices only.

TESTIMONY OF

PAUL G. FRITTS
DIRECTOR
DIVISION OF SUPERVISION
FEDERAL DEPOSIT INSURANCE CORPORATION

ON

REGULATION OF U.S. BRANCHES AND AGENCIES
OF FOREIGN BANKS

COMMITTEE ON BANKING, FINANCE AND
URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

9:30 AM
October 16, 1990
Room 2129, Rayburn House Office Building

Good morning, Mr. Chairman and members of the Committee. Thank you for the opportunity to express the views of the Federal Deposit Insurance Corporation on the regulation and supervision of U.S. branches and agencies of foreign banks. The FDIC staff has prepared answers to the questions contained in your letter of invitation, which are included in this statement.

Coordination of supervision of global banking institutions has improved markedly over the past two decades. The Basle Committee on Banking Supervision has been instrumental in fostering improved cooperation among national authorities. In 1975, the Basle Concordat was endorsed by the participating governors at the Bank for International Settlements. The Concordat held that no foreign banking establishment should escape supervision and that the supervision of foreign banking establishments should be the joint responsibility of host and parent authorities.

In 1983, the Committee published a revision to the Concordat which reiterated the objective of the original document -- namely, that no international banking operation should escape effective supervision -- and further addressed ways in which any supervisory gaps could be prevented. The revised Concordat holds that effective supervision of banks' foreign establishments calls for a sharing of responsibilities between host and parent supervisors, with the aim of ensuring that the soundness of individual banking groups operating in more than

- 2 -

one country is effectively and comprehensively monitored. In this spirit, much of the work of the Basle Committee on Banking Supervision has been directed toward promoting cooperation between supervisors and encouraging bilateral and multilateral exchanges of information.

The International Banking Act of 1978 (the Act) gave the three federal bank regulatory agencies expanded supervisory authority and responsibility with respect to the operations of foreign banks' U.S. branches and agencies. The distribution of supervision among the federal and state banking agencies calls for close coordination by the relevant authorities. Under the Act, the FDIC has primary federal examining authority, along with the various state authorities, over state licensed insured branches of foreign banks. State authorities have primary examining authority over state licensed uninsured branches and agencies.

The regulatory agencies' supervisory interests in the operation of U.S. branches and agencies of foreign banks are directed to the safety and soundness of those operations in serving the needs of borrowers and depositors and other creditors in the U.S. For this reason, the regulatory emphasis is on assessing the well-being of the U.S. offices. We are also concerned with adherence to U.S. law and regulation by these offices.

- 3 -

The Act mandated that the federal regulatory agencies cooperate closely with state banking authorities in examining U.S. offices of foreign banks. As a result of this mandate, a uniform approach to examining these offices was developed through the Federal Financial Institutions Examination Council (FFIEC). Our goal is to minimize dual examinations and to facilitate joint federal-state examinations, when desirable.

The federal regulatory agencies, through the FFIEC, in consultation with the relevant state authorities, have developed financial reporting requirements for U.S. offices of foreign banks. In addition, the agencies have developed reporting requirements for the foreign parent institutions which are somewhat similar to those for foreign bank holding companies.

The International Banking Act also provided for FDIC insurance for foreign branches. FDIC's Regulation 346 provides that any domestic branch of a foreign bank has the option of applying for FDIC insurance. Insurance is required, however, for state licensed branches engaged in domestic retail deposit activity and operating in a state which requires banks to have deposit insurance whenever the bank accepts deposits from the general public. The Comptroller of the Currency's regulations establish rules for federal branches. Those deemed by the Comptroller to require insurance must apply to the FDIC for insurance.

In carrying out its supervisory role, the FDIC has promulgated Regulation 346, part of which applies to both federal and state insured branches. Principle elements of the regulation call for a pledge of assets to the FDIC to protect the insurance fund and the maintenance of a capital-like cushion of certain eligible assets over liabilities. Both concepts are further explained in answer to Question 1.

1. What is the FDIC's role regarding the U.S. branches and agencies of foreign banks?

The International Banking Act enabled foreign banks to apply for federal branches and agencies. Prior to the Act, only state branches and agencies existed. All federal branches and agencies are subject to rules and regulations of the Comptroller of the Currency.

Agencies of foreign banks are not eligible for deposit insurance and, therefore, the FDIC does not play a role with respect to them.

However, the FDIC has a role with respect to insured U.S. branches of foreign banks. The International Banking Act provides that U.S. branches of foreign banks may apply for FDIC insurance. The Act, however, requires deposit insurance for branches which engage in domestic retail deposit taking; generally that means accepting deposits of less than \$100,000.

The FDIC has authority to issue rules and regulations as deemed necessary and, as insurer, has responsibility for determining the safety and soundness of an insured branch's operation. In order to make this determination, the FDIC periodically conducts examinations of insured branches.

In carrying out its supervisory role, the FDIC has promulgated regulations to which all insured branches of foreign banks are subject. FDIC regulations are designed to promote safety and soundness, as well as to protect the deposit insurance fund. FDIC regulations, for example, require a pledge to the FDIC of assets in the amount of five percent of the branch's average liabilities over a period of two calendar quarters. These pledged assets become the property of the FDIC to the extent necessary to protect the deposit insurance fund should the FDIC be called upon to pay insured deposits of the branch. The FDIC may require additional assets to be pledged if it determines that the foreign bank or branch's condition is such that the assets pledged will not adequately protect the insurance fund. Among the factors to be considered in imposing these requirements are the concentration of risk to any one borrower or group of related borrowers, or the concentration of risk to any one country, including the country in which the foreign bank's head office is located.

- 6 -

In addition, the FDIC requires insured foreign branches to maintain "eligible assets" of at least 106 percent of average liabilities of the branch as a form of capital cushion. Basically, "eligible assets" are assets other than those due from the foreign bank's head office, other branches or affiliates or those subject to classification as "Value Impaired or Loss" at the most recent examination. We also may require a higher ratio of eligible assets if the financial condition of the branch warrants such action, with concentration of credit risk being taken into consideration.

The asset pledge and asset maintenance requirements are necessary to afford some degree of protection to the insurance fund, as the FDIC has supervisory authority over only a portion of a much larger entity. The FDIC does not have the authority to impose higher capital requirements or otherwise regulate operations of the insured branch's parent.

2. Regarding the regulation and examination of these entities, please explain the coordination that occurs between the 50 states, the Comptroller of the Currency (OCC), the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC).

The FDIC and state bank supervisory authorities have primary supervisory responsibility for state chartered insured branches, and the state bank supervisory authorities have primary

- 7 -

responsibility for state chartered agencies and state chartered uninsured branches. The Office of the Comptroller of the Currency has primary supervisory responsibility in the case of federal branches and agencies. The International Banking Act provides that the Federal Reserve Board may examine any U.S. branches and agencies of foreign banks.

Examination of U.S. branches of foreign banks has been coordinated among the federal bank regulatory agencies and a number of state banking departments, as mandated in the International Banking Act, to ensure that each U.S. office of a foreign bank is examined regularly. Through the FFIEC, the federal banking agencies and various state supervisory authorities have developed a uniform examination approach for U.S. branches and agencies of foreign banking organizations and financial reporting requirements for U.S. offices of foreign banks.

3. Please provide financial information on FDIC-insured U.S. branches and agencies of foreign banks, including the number of such entities, aggregate balance sheet and income statement data, number of branches and agencies, and their total employees.

Of the 363 branches of foreign banks operating in the U.S. as of June 30, 1990, 55 branches of 27 foreign banks were insured. Aggregate total assets for the insured branches were

\$8.9 billion, and aggregate total deposits were \$4.3 billion. U.S. branches and agencies of foreign banks do not report income statement data or data on the number of employees to the federal supervisory agencies. As stated above, agencies of foreign banks are not eligible for insurance.

4. What percentage of the aggregate liabilities of these entities is insured by the FDIC?

An estimated 61 percent of the aggregate deposits of insured U.S. branches of foreign banks is insured and an estimated 29 percent of total liabilities of those insured branches is insured.

5. Please explain the FDIC's role in regulating the U.S. branches and agencies of foreign banks. How often are these entities examined by the FDIC? How many examiners does the FDIC have specifically dedicated to examining these entities? What type of examination does the OCC conduct (i.e. safety and soundness or compliance)? Do you have any recommendations for improving the regulation and examination of these entities?

The FDIC has promulgated rules and regulations (Part 346) pertaining to insured state and federally chartered U.S. branches of foreign banks. The governing regulation implements the insurance provisions of the International Banking Act of

1978 and sets out rules that apply to foreign banks that operate insured state or federal branches. The major provisions of Part 346 are the asset pledge and the asset maintenance requirements, referred to in response to Question 1. With respect to its supervisory role, the FDIC may examine the affairs of any office, agency, branch or affiliate of the foreign bank located in the United States as it deems necessary to determine the relations between the insured branch and such offices, agencies, branches, or affiliates and to assess the financial condition of the bank as it relates to the branch.

The FDIC assumes supervisory authority for state chartered insured U.S. branches of foreign banks. With respect to the frequency of examinations of such branches, the FDIC uses the same standards that are applicable to domestic FDIC supervised institutions. For branches that received a composite 1 or 2 rating at the last examination, the maximum interval between examinations is 24 months. For those branches receiving a composite rating of 3, 4, or 5, the maximum interval between examinations is 12 months.

Intervals for 1 and 2 rated institutions may be extended up to 48 months and intervals for 3 rated institutions may be extended up to 24 months when an interim state examination that meets FDIC needs has been performed. The FDIC does not specifically dedicate examiners to examining these entities, but draws from its general examination force.

- 10 -

With respect to the OCC's examinations, the OCC is in a better position to describe its own examination program.

At this time we have no recommendations with respect to the regulation and examination of insured U.S. branches of foreign banks. However, we point out the continued awkwardness of a system which insures only part of an institution (i.e. a branch of a bank), but not the entire institution. As to uninsured branches and agencies, the FDIC is not exposed and thus suggests that the public policy concerns should be addressed by others.

6. Please explain the enforcement authority of the FDIC as it pertains to the U.S. branches and agencies of foreign banks.

The FDIC has the same enforcement authority over insured U.S. branches of foreign banks as it has for state chartered insured domestic banks.

Enforcement authority includes the use of a memorandum of understanding, which is an informal means of documenting agreed upon corrective action with institutions with some supervisory concern, but which have not deteriorated to a point warranting formal administrative action. For more serious situations, formal administrative actions may be taken. These include the power to terminate insurance (Section 8(a) of the FDI Act), the power to issue Cease and Desist Actions (Section 8(b) of the FDI Act) and, if deemed necessary, to immediately invoke a temporary

- 11 -

Cease and Desist Action (Section 8(c) of the FDI Act). In addition, the FDIC has the power to suspend or remove a branch officer or director or prohibit participation by others in branch affairs when certain criteria can be established (Sections 8(e) and (g) of the FDI Act.) The FDIC has the authority to assess civil money penalties against both branches and individuals for violations of certain statutes. The Comptroller of the Currency has enforcement authority over federal branches and agencies; however the FDIC has the power to terminate insurance for federal insured branches. The FDIC has no authority over agencies.

7. Is the regulatory structure governing the U.S. branches and agencies of foreign banks adequate, or is the fragmented structure that now exists (i.e., the regulation and examination of these entities is divided among the OCC, FDIC, and Federal Reserve as well as the 50 states) prone to breakdown such as the one that occurred in the BNL-Atlanta case?

We believe the regulatory structure that now exists is as adequate as it is for the banking system as a whole. In the case of the BNL-Atlanta agency, the situation was one of massive fraud. Certain Iraqi credits were not booked by the agency or reported in quarterly financial reports. Collusion on the part of the agency's employees to hide the transactions hindered .

- 12 -

discovery of the transactions by the examiners. The agency is not insured and the FDIC has no authority over it.

STATEMENT OF STEPHEN R. STEINBRINK
DEPUTY COMPTROLLER, MULTINATIONAL BANKING
OFFICE OF THE COMPTROLLER OF THE CURRENCY
BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES
OCTOBER 16, 1990

Mr. Chairman and members of the Committee:

Thank you for the invitation to testify today about the Office of the Comptroller of the Currency's (OCC) regulation and supervision of U. S. branches and agencies of foreign banks and, in particular, the OCC's Federal Branch Program. We welcome the Committee's interest in this area of bank supervision and appreciate the opportunity to share with you our efforts to assure the safety and soundness of the national banking system through the regulation and supervision of Federal branches and agencies.

OCC involvement in the regulation and supervision of branches and agencies of foreign banks began with passage of the International Banking Act (IBA) of 1978. The IBA affords foreign banks the opportunity to apply for a Federal branch or agency license in those states where the bank is not operating a State branch pursuant to State law and the establishment of a branch or agency is not prohibited by State law. The IBA identified the OCC as the U. S. bank regulatory agency charged with primary responsibility for supervising Federal branches and agencies. The OCC is responsible for acting on applications to license Federal branches, performing examinations, and providing an overall system of supervision.

convert to a Federal branch must have a record of sound operation as a State licensee in order to qualify for a Federal license. For Federal branch applications, this Office contacts the home country supervisor as to the financial ability and record of performance of the parent bank.

The IBA requires the OCC to perform an examination of each Federal branch at least once each calendar year. The regularity of examinations assures compliance with the requirements of national banking law.

Generally Federal branches and agencies are exposed to the same risks, are subject to the same laws, rulings and regulations and are examined in much the same way as a national bank. However, because they are not separate legal entities and are only extensions of the parent, their operations may differ in some areas. For example, because Federal branches and agencies are an extension of the parent bank, they do not have a separate capital structure. Therefore they are required to maintain a pledge of assets known as a capital equivalency deposit, more commonly known as a CED account. The OCC has developed specific examination procedures and a series of Federal branch banking circulars to address supervisory, policy and operational issues which are of particular importance to these banking entities. The circulars provide guidance in areas such as allowance for loan and lease losses, capital equivalency deposit accounts, and funds due from home and related offices. Finally, our examination of Federal branches and agencies is always tempered with common sense recognizing that these entities are U. S. branch offices of foreign banking companies which are supported by the financial and managerial abilities of those companies.

The letter of invitation asked whether the regulatory structure governing U. S. branches and agencies of foreign banks is adequate or whether the fragmented structure that now exists (i.e., the regulation and examination of these entities is divided among the OCC, the FDIC, and the Federal Reserve as well as the 50 States) is prone to breakdowns such as the one that occurred in the BNL-Atlanta case. Banca Nazionale Del Lavoro's Atlanta branch is not a Federal branch and is not subject to OCC supervision or regulation and consequently, I can not comment on the specific case. We believe that cooperation, communication, and sharing of information with other domestic regulators such as the Federal Reserve and FDIC and the home country regulator of the parent bank, are essential to ongoing supervision.

Your letter also asked us to explain the OCC's role in regulating the U. S. branches and agencies of foreign banks and the type of examination the OCC conducts (i.e. safety and soundness or compliance). The OCC conducts full scope examinations of Federal branches and agencies including reviews of asset quality and other solvency related issues. As you may know, the Basle Committee on Banking Regulations and Supervisory Practices has agreed upon certain principles for the regulation and supervision of international banks. The Committee has agreed that while there is a general responsibility on the host authority to monitor the financial soundness of branches of foreign banks, supervision of solvency is primarily a matter for the parent authority. Despite the agreement in

-7-

There also is a common interest in approaching the supervision of foreign banks on a basis consistent with their domestic counterparts. There should be equality of supervision and regulation as well as equality of competition.

Finally, we believe that banking regulators around the world must develop better systems of communication and cooperation. As global banking companies expand, mechanisms for sharing supervisory information between home and host country regulators must be developed in order to assure proper supervision of worldwide banking companies.

Thank you for the opportunity to share with you information about our efforts to provide proper supervision and regulation of Federal branches and agencies. I would be happy to respond to any questions.

TESTIMONY OF
JAMES E. GILLERAN
ON BEHALF OF
THE CONFERENCE OF STATE BANK SUPERVISORS
BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
OCTOBER 16, 1990

BACKGROUND

Before proceeding to the issues raised in your letter of invitation, some brief background on the presence of foreign banks in the United States may be helpful to the Committee.

The first foreign bank to establish operations in the United States was the Bank of Montreal in 1818. Over three-quarters of the foreign banks present in the United States were formed after 1970. The reason for this growth is the improved communication technology coupled with the globalization of the United States economy.

Foreign banks can enter the United States through four main avenues. The first, and easiest to establish, is a representative office. A representative office cannot make loans or accept deposits. Its main function is to facilitate business contacts in the United States for the parent bank's home country client base operating in the United States. Studies have shown that a majority of foreign banks operating in the United States begin with representative offices, and later expand into a wider range of activities.

The next type of foreign bank entity is the agency. An agency can make commercial or industrial loans, but is generally barred from accepting deposits or making consumer loans. These agencies

do maintain credit balances for their foreign client bases, but most forms of payments cannot be made from these accounts. These agencies are mainly funded by their parent banks or by borrowing on the interbank markets.

The 194 state licensed foreign banks agencies currently operating in the United States hold \$90.2 billion in assets.

The branch is the most important foreign bank entity. Branches operate on the consolidated equity of the parent bank. These branches vary according to their power to accept deposits. In California, for example, we permit three types of foreign branches: wholesale, limited, and retail. Wholesale branches accept only deposits greater than \$100,000, and are not insured by the FDIC. Another non-FDIC insured branch is the limited branch. This entity may only accept non-U.S. customers' deposits or deposits related to international trade arrangements.

Retail branches are FDIC insured and accept deposits from any customer in any denomination. There are five FDIC-insured branches in California that hold \$654 million in assets. For comparison, there are 16 FDIC-insured branches in New York and nine in Illinois. By providing these various types of branch operations, we can provide the vehicle for foreign bank entry appropriate to their business in the United States. FDIC-insured foreign branches pay Bank Insurance Fund premiums based on their deposit base.

There are 279 state licensed foreign branches in the United States, holding \$438 billion in assets.

The final method of foreign bank entry is through a full service bank subsidiary. The subsidiary bank may be either state or federally chartered, and the Federal Reserve Board must approve its acquisition under the Bank Holding Company Act. State law controls foreign bank acquisitions of bank subsidiaries in the same manner the Douglas Amendment to the Bank Holding Company Act controls acquisitions by domestic bank holding companies. These subsidiary banks face the same regulation and restrictions as other domestic U.S. banks.

There are currently 74 foreign-owned state chartered commercial banks, with \$89.2 billion in assets.

Two other forms of foreign bank entities operate in the United States. The first are New York Investment Companies. These are incorporated entities licensed by the state of New York with powers similar to agencies. There are currently 10 of these companies, with \$4.5 billion in assets. The International Bank Act of 1978 (IBA) allowed the Federal Reserve Board to charter Edge Act Corporations for foreign banks. There are 24 foreign Edge Act Corporations, with nearly \$3.0 billion in assets.

In your letter of introduction, you asked specifically for information on branches and agencies. I will restrict the remainder of my comments to these two types of foreign bank entities. It is important to keep in mind, however, that the other foreign bank entities play a significant role in the U.S. banking system, particularly foreign-owned banks. For example, there are 22 state-chartered, foreign-owned banks in California, which hold \$26.4 billion in assets. This represents over 35 percent of the state-chartered bank assets in California.

Foreign banks from more than 60 countries have some form of office in the United States. Not surprisingly, our largest trading partners hold the greatest number of foreign bank assets: Japan, Canada, Italy, West Germany, France and the United Kingdom. Hong Kong, Israel, Switzerland and the Netherlands round out the top ten. Banks from these ten countries hold over 90 percent of the foreign bank assets.

Foreign banks are located in sixteen states. Of these, New York has the largest concentration of activity with almost two-thirds the total assets. California is second, and is particularly attractive to the Pacific Rim countries, including Japan. Illinois, Florida and Georgia have significant concentrations of foreign assets. Given the importance of New York City, Chicago, Los Angeles, San Francisco, and Atlanta as major financial centers for domestic commerce and international trade and Florida's

preeminent role in trade with the Caribbean Basin and Latin America, this concentration is not surprising.

Prior to 1978, the federal banking agencies had little involvement with foreign bank branches and agencies. These entities were exclusively state-licensed and supervised. The International Bank Act of 1978 expanded the federal agencies' role with foreign bank branches and agencies in a number of ways. First, it allowed the Office of the Comptroller of the Currency (OCC) to license foreign bank branches and agencies. Currently, there are 100 federally licensed branches or agencies that hold \$36.5 billion in assets. This is approximately 15 percent of the total institutions, or 5 percent of the assets.

The IBA also instituted the "home state" restriction. This restriction requires foreign bank branches, state or federally licensed, to designate "home state". The branch is treated as a domestic bank for geographic expansion purposes. CSBS strongly objected to the original version of the "home state" restriction, since it would have tended to concentrate all of the foreign bank asset in one or two states, thereby preventing other states from participating in the enhanced trade finance and credit opportunities. The original provisions, however, were narrowed to require only the deposit-taking function to be restricted to one state, and a number of grandfathering provisions were included. This allowed the development of uninsured agencies and branches to

meet the economic demand for these services in other states. The provision instituted "national treatment" for foreign banks by subjecting them to similar geographic restrictions as U.S. banks.

The IBA placed a number of other requirements on foreign bank branches and agencies. It gave the Federal Reserve the authority to impose minimum reserve requirements on state and federal licensed branches and agencies. It required FDIC insurance for all foreign branches and agencies that accepted retail deposits. Foreign banks were subjected to the non-bank activities restrictions contained in the Bank Holding Company Act and anti-tying provisions. The Federal Reserve, as mentioned before, received the authority to charter Edge Act Corporations for foreign banks in the U.S.

Section 7(c)(6) of the IBA authorized the Federal Reserve to examine any foreign bank branch or agency, whether state or federally licensed. The same section encourages the Federal Reserve to use the examination reports of the other federal and state banking agencies when possible. In addition, the IBA directed the Federal Reserve to consult with the states banking authorities before instituting restrictions and regulations on state-licensed foreign bank branches or agencies.

The Federal Reserve has general enforcement authority over state-licensed foreign bank branches or agencies. These powers

include cease-and-desist orders, civil money penalties and other enforcement actions contained in Section 8 of the Federal Deposit Insurance Act. The Federal Reserve uses this authority to enforce the applicable portions of the Federal Reserve Act and the International Banking Act. There appears to be overlapping federal enforcement authority over FDIC-insured foreign bank branches by the FDIC and the Federal Reserve.

SUPERVISION OF STATE-LICENSED FOREIGN BANK BRANCHES AND AGENCIES

As indicated above, the state banking department is the primary supervisor of state-licensed foreign bank branches and agencies. As primary supervisor, state banking departments perform the same functions with these entities as with domestic state-chartered commercial banks. These functions are:

- o licensing the entity to operate in the state;
- o examining the operation of the branch to determine that the branch is operating within the laws and regulations of the state;
- o supervising the activities of the branch through examinations and other financial reports; and
- o regulating the branch's activities.

If a branch becomes financially troubled or commits a serious violation of law, the state supervisor has the full range of enforcement tools at his or her disposal, including closing the foreign bank branch or agency.

The licensing process for a foreign bank branch or agency is similar to the chartering process for domestic state banks. Each application is reviewed to determine the business purpose of the branch and the motive for establishing the branch, the financial condition and earnings history of the parent bank, the home country supervision, the forecast of the expected operations, the proposed branch management, and the public convenience and advantage to be served. California, New York, and several other states require state-licensed foreign bank branches to pledge securities to secure performance of all the branch's financial arrangements in the state. These pledged assets provide a liquidation fund in case of failure.

State banking departments are primarily responsible for examinations of foreign branches or agencies. The IBA gave the Federal Reserve the authority to examine any federal or state branch or agency. However, the IBA clearly states that the licensing agency, either state or federal, is vested with the "primary examining authority" and that the Federal Reserve has "residual" examination authority to "ensure full compliance" with the IBA. Further, the IBA requires the Federal Reserve to make full use of the examination reports produced by the states or the Comptroller in fulfilling its responsibilities.

The vast majority of state-licensed foreign bank branches or

agencies are examined annually. California alternates yearly examinations with the Federal Reserve. In California, a foreign bank branch or agency is examined every year by one of the two regulators. New York performs examinations on either a 12- or a 24-month cycle, depending on the entity's rating, the strength of the parent, and the assessment of the country risk. Any entity not on the 12-month, full-scope examination cycle is subject to special visitations, described below. A few states require examinations every 18 months. All examination reports are provided to the appropriate federal regulator, the parent bank, and its primary regulator.

State foreign bank branches are also subject to periodic visitations by their state regulators. These visits do not entail a full scope examination, but update the overall condition of the branch or agency and target a specific aspect of the entities operations. Nothing precludes a state regulator from scheduling examinations on a more frequent basis if the situation requires.

In addition to examinations and visitations, the foreign bank branches or agencies submit earnings and conditions reports throughout the year. In California, we require quarterly reports of condition and semi-annual reports of earnings. These reports are used to facilitate off-site monitoring of these entities.

Personnel used to examine foreign bank branches and agencies

are generally drawn from the existing examiner pool, which performs examinations on all state chartered entities under the banking department's purview. As you are aware, the debate continues on whether examination personnel should concentrate on a single type of institution, as is the case for the federal regulators and in states such as Florida, or whether examiners should work in all types of financial institutions, as in California and New York. Both approaches have valid arguments in their favor. In both systems, the senior examination personnel in charge of foreign bank branches and agencies have specialized training in the field of foreign bank examination. Similarly, supervisory personnel have specialized training in supervising foreign bank branches and agencies. These supervisory personnel are usually assigned exclusively to the oversight of foreign bank branches or agencies, and have significant expertise in this area.

COOPERATION AMONG REGULATORS

Given the role of the Federal Reserve and the relatively few FDIC-insured foreign bank branches and agencies, the vast majority of cooperation takes place between the state regulators and the Federal Reserve and among the states themselves. Our working relationship with the Federal Reserve is good. While the relationship varies from state to state, all report a close working relationship. We have less experience with the FDIC or the OCC in the area of foreign bank branch or agency regulation. As for domestic banks, we have excellent working relations with the FDIC,

but have not had sufficient contact with the OCC to draw any firm conclusions.

There are a number of initiatives by the states that are improving cooperation between the states and the foreign bank branches and agencies we license.

A number of states recently signed an information-sharing agreement on the supervision of foreign banks. The signatories to this agreement are California, New York, Illinois, Florida, Georgia, Michigan, and Washington. This agreement provides for the confidential exchange of information between the states about foreign banks operating within their borders. Information exchanged includes financial condition, examination ratings, business practices, compliance records, and the banks' record with its home country supervisor and its parent organization. We anticipate that other states will sign this agreement. The agreement's aim is to further strengthen state supervision of the entities and to provide a means for monitoring foreign bank entry and activities in other states.

Another initiative to strengthen the supervision of these entities is an outgrowth of the state experience with multi-state bank holding companies. We find it necessary with these organizations to schedule the examination of the entire holding company, including the holding company itself and all its insured

affiliates, concurrently in order to get an accurate picture of its health. This takes a great deal of flexibility and coordination from all of the regulators involved, both state and federal. While the level of cooperation of our fellow regulators varies, the states remain committed to this initiative and continue to aggressively pursue the coordinated examination of multi-state bank holding companies.

We are now applying the same coordinated examination scheduling to foreign bank branches or agencies. The strong history of cooperation between state regulators and the Federal Reserve experienced in foreign bank branch regulation make us enthusiastic about this program. We will keep this Committee informed of our progress.

RECOMMENDATIONS

You asked for our recommendations on improving the regulation and examinations of these entities. As I discussed earlier, we have taken several initiatives to improve state supervision of these entities. Other changes will help, although several of these do not require federal legislation.

First is in the area of cooperation. The IBA requires consultation with the states by the Federal Reserve on a number of matters. The consultation on policy issues should be more regular, and formalized consultation should take place when major issues are

on the table. Regular meetings should be scheduled between the Federal Reserve and all state regulators who have responsibilities over foreign bank branches and agencies.

The states should be represented by one of our own in the international meetings that impact on the foreign bank branches or agencies we regulate, as well as the domestic state banking system. The Basle Committee is the primary vehicle for international coordination of bank supervision. The committee is made up of two representatives from 10 of the 12 industrialized countries, generally referred to as the G-12 nations. Luxembourg has only one representative and the United States has at least four. None of these four United States representatives represents the states directly in their role with foreign bank branches or domestic state banks. States charter and regulate over 40 percent of the domestic bank assets and over 80 percent of the foreign bank assets. Given these facts and the scope of the impact of the Basle Committee's deliberation and decisions on state regulated institutions, the lack of direct state participation is unjustifiable and deserves this Committee's attention.

Our final recommendation at this time is the expansion of the federal criminal code to include crimes by employees of foreign bank branches or agencies. We supported your efforts, Mr. Chairman, to address this issue in the crime bill, and were disappointed to see that the provisions were not offered. By

subjecting these individuals to criminal sanctions under Title 18, you will bring the substantial resources and expertise of the U.S. Attorney's offices and the Justice Department to bear on these cases. These penalties would be in addition to current state criminal sanctions, and provide increased deterrence to individuals considering criminal acts.

This is not to say that the individuals under investigation in the BNL incident will not be subject to criminal prosecution under current law. The state criminal system provides timely and substantial justice to those accused of fraud. We have recently seen this in action in the Keating case. In addition, those accused of crimes in connection with the BNL-Atlanta incident face jail in the Georgia State Prison System. That prospect alone will give most white-collar criminals reason to pause.

CONCLUSION

I do not have any direct knowledge of activities that took place at BNL-Atlanta, nor do I have any information on the investigations of that situation other than press reports. As you have pointed out, Mr. Chairman, this case appears to have involved massive fraud. This type of fraud is difficult or impossible to detect, and this criminal activity may be successful for a short period of time. However, the combination of internal controls and audits, external audits, and on-site regulatory examinations will ultimately bring this activity to light or drive one of the

conspirators to come forward. During the on-site examinations, examiners will often receive tips from bank employees and others regarding fraudulent activities.

It is fraud, not a breakdown in the regulatory system of foreign bank branches and agencies, that is present in this case. From the information available to us, it appears that the regulatory system worked.

Foreign bank branches or agencies are adequately regulated, supervised, and examined under the current regulatory scheme. As described above, they receive timely on-site examinations and visitations, and are subject to a number of off-site monitoring activities. They receive the same regulatory review as domestic state-chartered banks.

These institutions perform a critical function in our economy. They bring necessary trade finance and expertise to our domestic industries. They also provide substantial capital investment in those companies. Any proposals to change the regulation of foreign bank branches and agencies must carefully consider the potential impact on the economies of the communities the institutions serve. In addition, any change in the regulation of foreign bank branches and agencies will impact on international trade negotiations and this impact must be considered.

Summary of U.S. Offices of Foreign Banks
By Charter Type and Type of Institution
(3/31/90)

	<u>Number of Institutions</u>	<u>Assets (000's)</u>
A) State		
1. Agencies	194	\$ 90,181,020
2. Branches	279	438,188,678
3. Foreign-Owned CB's	74	89,239,291
4. NY Investment Co.'s	10	4,561,597
5. Edge Corporation	<u>-</u>	<u>-</u>
Total	557 (77.8%)	\$622,170,586 (85.6%)
B) Federal		
1. Agencies	29	\$ 2,436,578
2. Branches	81	34,159,534
3. Foreign-Owned CB's	25	64,676,870
4. NY Investment Co.'s	-	-
5. Edge Corporations	<u>24</u>	<u>2,997,278</u>
Total	159 (22.2%)	\$104,270,260 (14.4%)
C) Totals	716 (100.0%)	\$726,440,846 (100.0%)

Source: Federal Reserve Board and Conference of State Bank Supervisors.

**CALIFORNIA STATE
BANKING DEPARTMENT**

**A GUIDE TO
FOREIGN BANKING
IN CALIFORNIA
SEPTEMBER 1990**

**George Deukmejian
Governor**

**James Gilleran
Superintendent of Banks**

**CALIFORNIA STATE
BANKING DEPARTMENT**

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HOW TO DO A BANKING BUSINESS IN CALIFORNIA

There are a number of ways in which a foreign nation bank can establish a banking operation in California as discussed below:

SUBSIDIARY BANKS

Foreign banks can either acquire an existing bank or establish a new subsidiary bank in California. Applicants can seek either a national or state charter for their proposed bank. Presently there are 25 foreign-owned subsidiary banks operating in California of which 22 are state chartered and regulated by the State Banking Department. If the foreign bank will own or control at least 25 percent of the subsidiary California bank, the Federal Reserve Bank must also approve the foreign parent bank as a holding company. A foreign bank seeking to enter the U.S. is subject to the International Bank Act of 1978. One provision of the Act stipulates that a foreign bank must choose one state as its "Home State". There are presently 28 foreign banks which have selected California as their "Home State".

There are no special restrictions imposed on foreign applicants. Foreign applicants go through the same application and licensing procedures as do domestic applicants. Once approved, they are subject to the same reporting and examination requirements as any domestic state chartered bank.

The general standards followed in granting approval of a new bank are found in the California Banking Law and include considerations such as:

1. Establishing the need for the bank.
2. Establishing that the public convenience and advantage will be served by the new bank.
3. Demonstration that there is a reasonable promise of successful operation.
4. Showing that competent management will be employed.

A California banking license has no expiration date. Banks are assessed annually on the basis of their assets as of June 30th, as the means of providing financial support for the Banking Department. Relevant sections of the Financial Code begin at Section 350, and Regulations Section 10.3000.

OFFICES OF FOREIGN BANKS

Foreign banks may also establish an Office in California. These offices include both agencies and branches. They operate as integral parts of the parent institution and operate on the consolidated equity of the parent bank. Offices can be deposit taking or non-depositary. There are four kinds of licensed deposit taking offices:

HOW TO DO A BANKING BUSINESS
PAGE TWO

1. Wholesale branch - can accept deposits of \$100M and over. These deposits are not insured by the FDIC.
2. Limited branch - can accept deposits from non U.S. customers and from U.S. customers only if they are related to international trade.
3. Retail branch - can accept local deposits and deposits of any denomination. Deposits under \$100M are insured by the FDIC.
4. Depository agency - can accept deposits from foreign customers only. Deposits are not insured by the FDIC.

Foreign banks may also establish an agency office that does not accept deposits.

All of the above offices generally function to facilitate international trade through the use of letters of credit and acceptances and other loans to finance imports and/or exports. These offices participate in large loan/credit syndications and their operations are generally funded through the limited deposit procedures described above and through funding by the head office and affiliates.

The licensing procedures include an investigation into the bank's motives for establishing the branch, earnings history of the bank, its financial condition, and proposed branch management. Prior to licensing, the applicant must pledge securities with the State Treasurer to secure the faithful performance of all obligations entered into in California. While the Superintendent determines the amount to be pledged, the amounts generally have been in the range of \$500M. The license issued has no expiration date. Agencies are assessed annually based on assets as of June 30th of each year. Relevant statutes are found in Financial Code Sections 1700, et seq. and Regulations Sections 10.14000 et seq.

Agency and branch offices of all types are required to submit quarterly reports of condition and earnings reports twice a year. Agencies and branches are examined by the State Banking Department and the Federal Reserve Board every alternate year so that offices are examined annually by one of the two regulators.

REPRESENTATIVE OFFICES

These offices cannot accept deposits nor make loans. They are usually set up to facilitate contacts/business for their domestic client base. No reporting requirements have been set for these offices and we rarely exercise our privilege of examining these offices. Please see Financial Code Section 1725 et seq. and Regulation Section 10.13100 et seq.

SOME FACTS ABOUT CALIFORNIA

- California's economy is diverse - the sixth largest in the world. California is America's largest consumer market, with one of the world's highest per capita incomes.
- Twenty-four of the world's largest 25 banks are present in California.
- Twenty-nine countries are represented in California through their banking offices.
- California is second in the U.S. both in terms of the number of foreign banking corporation offices and in assets of foreign banks operating here.
- As of June 30, 1990, California's 122 offices of 102 agency and branch offices of foreign banking corporations had total assets of \$84.3 billion, making up nearly 20 percent of the total banking assets in the state.
- June 30, 1990 assets of foreign banking corporations have increased by 126% since June 30, 1982, increasing from \$37.3 billion to \$84.3 billion. State chartered banks' assets grew from \$63.3 billion to \$103.1 billion during that period.
- California has 22 state chartered bank subsidiaries of foreign banks with total assets of \$36.4 billion - representing over 35 percent of total state chartered bank assets.
- California leads the U.S. in the level of foreign investment with over 2,200 foreign-owned firms employing 300,000 Californians.

CALIFORNIA BANKING PROFILE

	<u>June 30, 1990</u>		<u>June 30, 1982</u>		
	<u>No.</u>	<u>Assets</u>	<u>No.</u>	<u>Assets</u>	<u>\$ Change</u>
		(Billions)		(Billions)	
State Chartered Banks	267	\$103.1	255	\$ 63.3	62.9
National Banks	165	235.2	79	204.1	15.2
Bank Totals	432	\$338.3	334	\$267.4	26.5
Foreign Agencies/Branches	102	84.3	103	37.3	126.0
California Total	534	\$422.6	437	\$304.7	38.7
Bank Holding Companies					
State	104		61		
National	61		23		

PROFILE OF STATE CHARTERED BANKS - DOLLAR AMOUNTS IN THOUSANDS

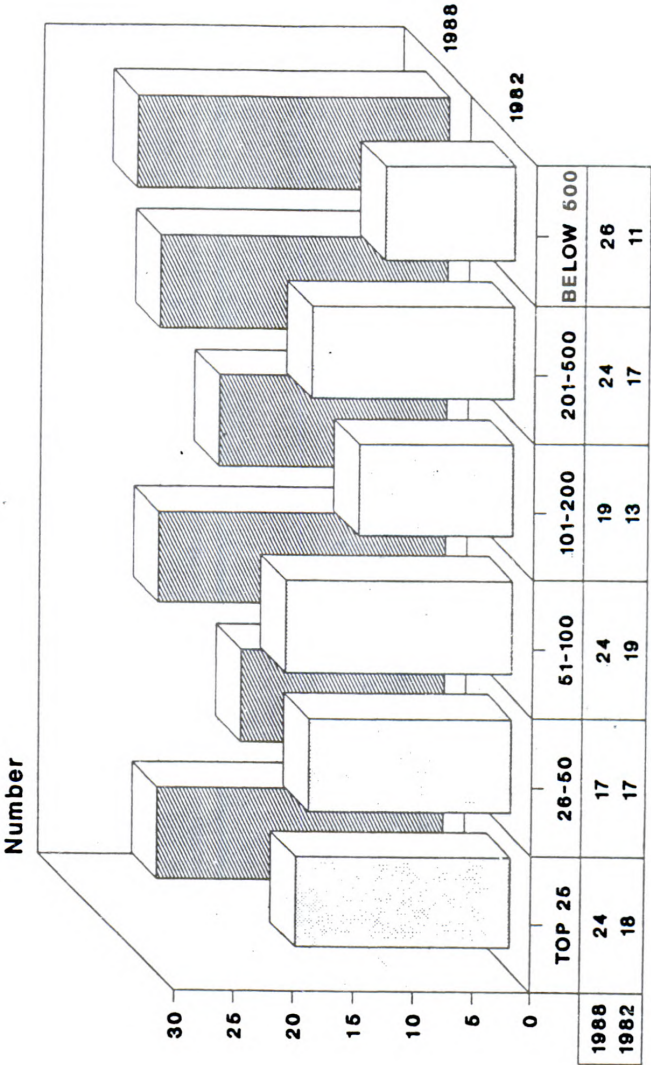
Period Ending	12/31/85	12/31/86	12/31/87	12/31/88	12/31/89	6/30/90
Number of Banks	285	287	279	270	267	267
Loans & Leases (Net)*	54,351.0	59,553.0	60,738.8	60,696.8	67,586.5	71,191.8
Reserve for loans	672.4	808.7	1,493.1	1,328.9	1,263.1	1,244.2
Total Assets	82,433.0	92,402.2	91,242.6	94,492.5	101,624.1	103,079.6
Total Deposits	69,288.4	78,847.7	77,109.1	78,910.2	84,908.8	84,581.9
Total Equity Capital	5,159.4	5,743.0	5,741.3	6,003.3	6,942.5	7,343.3
Loans >90 Days Delinq.**	1,639.9	1,626.2	1,915.7	1,468.3	1,341.9	1,400.1
Total Delinquent Loans	3,132.7	3,060.7	3,568.7	2,807.9	2,746.1	2,750.8
Interest Earned	7,546.5	7,274.9	7,645.7	7,355.1	9,522.4	4,837.1
Interest Expense	4,073.9	3,586.9	3,493.5	3,415.5	4,701.7	2,417.9
Net Interest Income	3,472.6	3,688.0	4,152.2	3,939.6	4,820.7	2,419.2
Loan Loss Provision	517.6	597.2	1,244.5	395.3	506.0	206.5
Total Overhead	2,873.5	2,862.8	3,909.3	2,771.7	3,200.5	1,419.5
Operating Income	599.1	825.2	242.9	1,167.9	1,620.2	999.7
Net Income	428.7	552.2	83.1	800.6	1,029.7	588.1
Return on Assets***	.52	.60	.09	.86	1.01	1.14
Return on Equity***	8.31	9.62	1.45	13.34	14.83	16.02
Net Interest Margin***	4.21	3.99	4.55	4.17	4.74	4.69

*Net of unearned income.

**Includes nonaccrual.

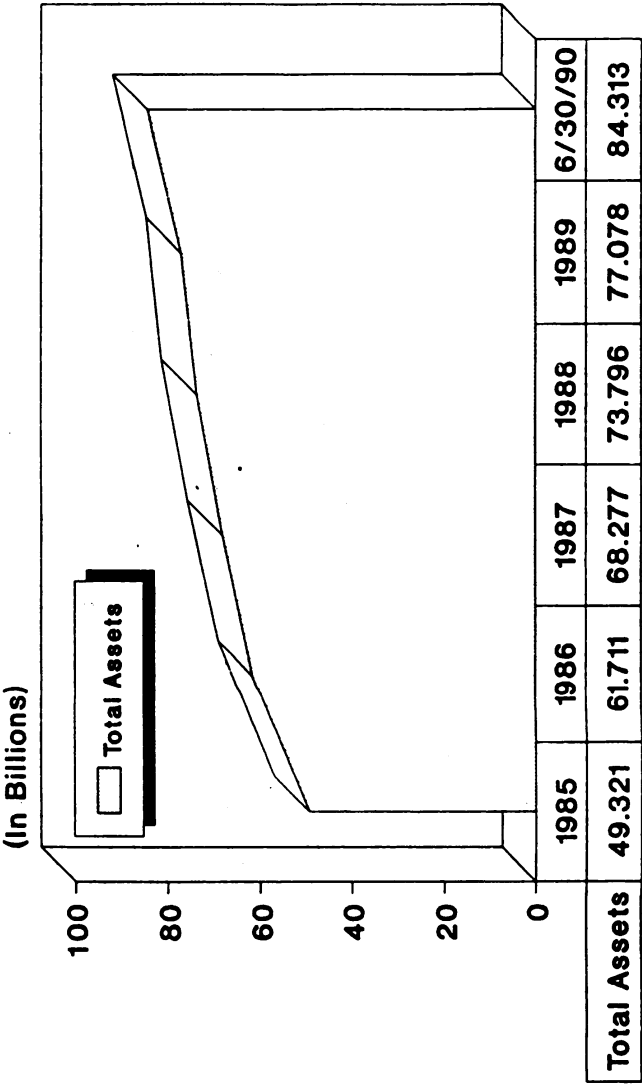
***Annualized for 6/30/90.

FOREIGN BANKS WITH REPRESENTATION IN CALIF. GROUPED BY THEIR WORLD RANKING (State Chartered Only)

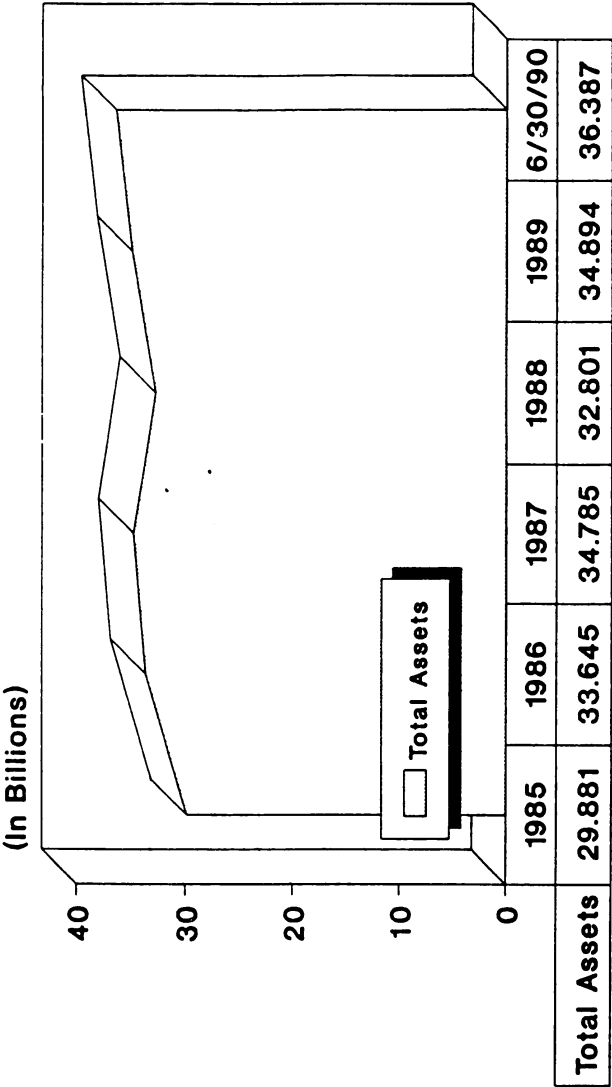


Source: American Banker

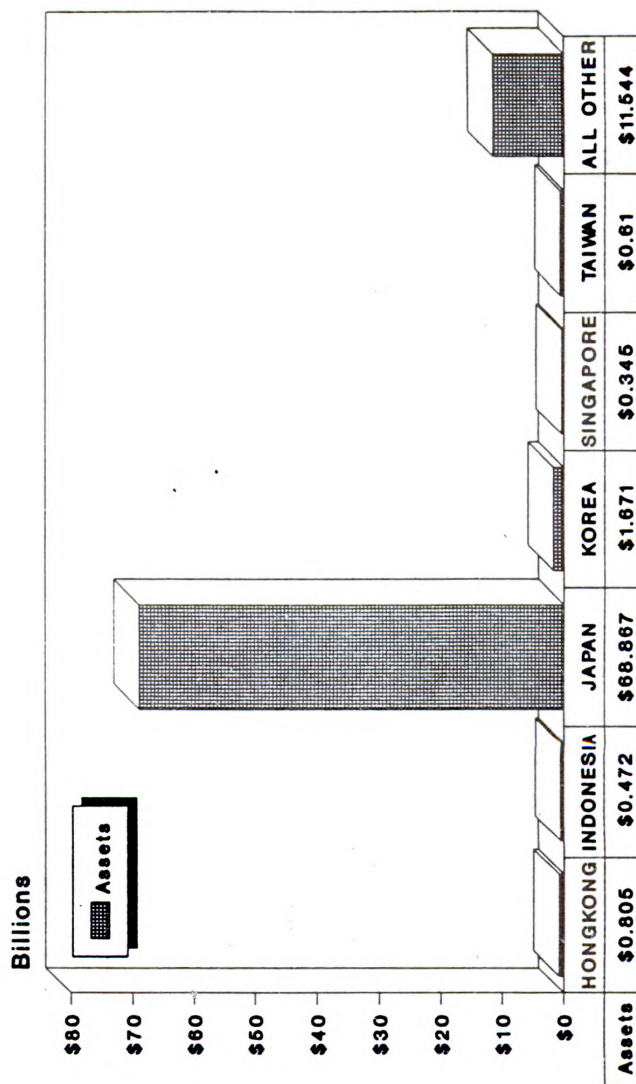
**ASSETS OF BRANCH AND AGENCY OFFICES
OF FOREIGN BANKING CORPORATIONS**
(California State Chartered Only)



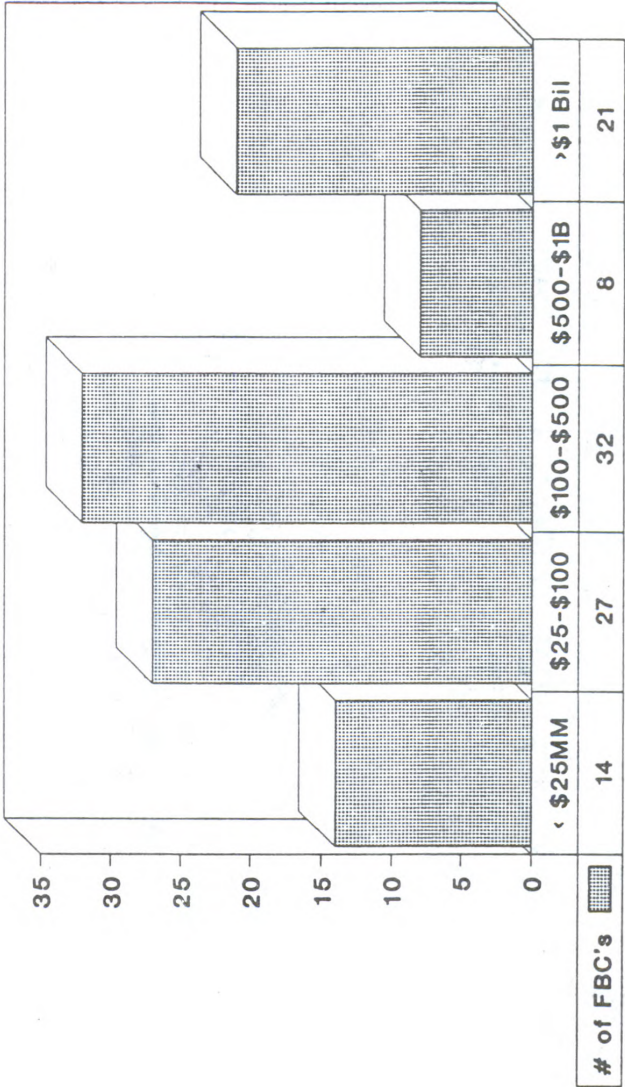
ASSETS OF CALIFORNIA STATE CHARTERED BANKS OPERATED AS SUBSIDIARIES OF FOREIGN BANKS



ASSETS OF BRANCH AND AGENCY OFFICES OF FOREIGN BANKING CORPORATIONS BY SELECTED COUNTRIES

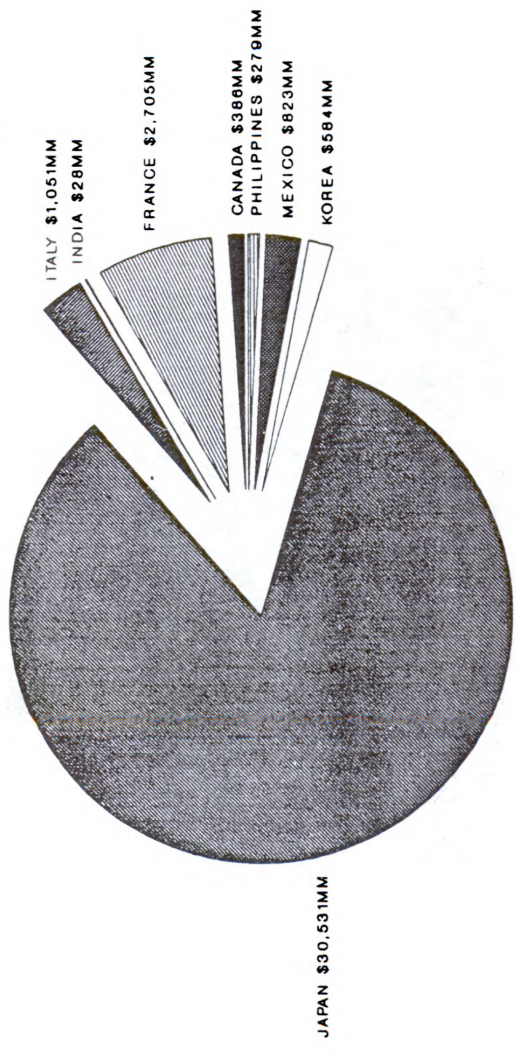


BRANCH AND AGENCY OFFICES OF FOREIGN BANKING CORPORATIONS GROUPED BY ASSET SIZE

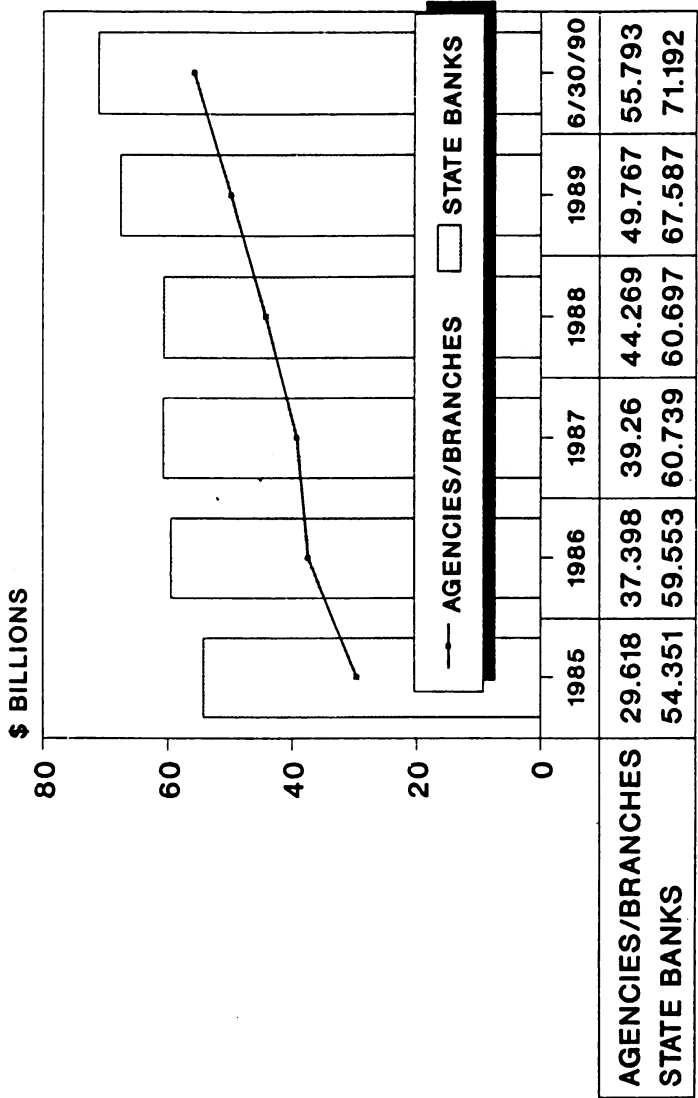


(As of 6/30/90)

ASSETS OF SUBSIDIARIES OF FOREIGN BANKS BY COUNTRY OF ORIGIN



**TOTAL LOANS* MADE BY STATE CHARTERED
BANKS AND AGENCIES/BRANCHES IN
CALIFORNIA - AN OVERVIEW**



*Loans & leases (net of unearned inc.)

**TOTAL ASSETS OF FOREIGN BANKS WITH REPRESENTATION
IN CALIFORNIA BY COUNTRY OF ORIGIN**
(State Chartered only)
(In thousands of dollars)

<i>Name of Bank (by Country of Origin)</i>	<i>Total Assets Agency/Branch</i>	<i>Total Assets California Corporate Subsidiary</i>
Australia		
Australia and New Zealand Banking Group, Ltd. b	\$158,399	
Commonwealth Bank of Australia a	28,852	
National Australia Bank, Limited b	165,029	
	<hr/>	
	\$352,280	
Brazil		
Banco do Brasil, S.A. b	\$605,029	
Banco do Estado de Sao Paulo b	91,695	
Banco Real, S.A. b	86,445	
	<hr/>	
	\$783,169	
Canada		
Bank of Montreal		\$6,936 Harris Trust Co. of CA
Bank of Nova Scotia (The) b	\$1,309,768	
Canadian Commercial Bank (In Liquidation)		248,002 Commercial Center Bank
Canadian Imperial Bank of Commerce a	0	131,467 Canadian Imperial Bank of
National Bank of Canada a	1,000	Commerce (California)
Royal Bank of Canada (The) b	535	
Toronto-Dominion Bank (The) b	526	
	<hr/>	
	\$1,311,829	<hr/>
		\$386,405
Denmark		
Aktivbanken, A/S b	\$59,311	
Den Danske Bank Aktieselskab c	46,259	
	<hr/>	
	\$105,570	
El Salvador		
Banco Agricola Commercial de El Salvador a	\$921	
France		
Banque Indosuez c	\$96,130	
Banque Nationale de Paris b	1,151,009	\$2,704,721 Bank of the West
Banque Paribas a	484,764	
Caisse Nationale de Credit Agricole c	4,711	
Credit Lyonnais e	62,023	
Societe Generale c	86,118	
	<hr/>	
	\$1,884,755	<hr/>
		\$2,704,721

**TOTAL ASSETS OF FOREIGN BANKS WITH REPRESENTATION
IN CALIFORNIA BY COUNTRY OF ORIGIN**

(State Chartered only)
(In thousands of dollars)

<i>Name of Bank (by Country of Origin)</i>	<i>Total Assets Agency/Branch</i>	<i>Total Assets California Corporate Subsidiary</i>
Germany		
Bayerische Vereinsbank (Union Bank of Bavaria) b	\$43,631	
Commerzbank Aktiengesellschaft c	434,228	
Deutsche Bank, AG c	19,721	
DG Bank Deutsche Genossenschaftsbank c	513,078	
Dresdner Bank, A.G. b	161,982	
	<hr/>	
	\$1,172,640	
Hongkong		
Chekiang First Bank, Limited b	\$254,466	
Hong Kong and Shanghai Banking Corp. (The) c	333,892	
Lin Chong Hing Bank, Ltd. b	35,439	
Shanghai Commercial Bank, Limited b	181,672	
	<hr/>	
	\$805,469	
India		
Bank of India b	72,358	
State Bank of India b	99,957	\$27,857 State Bank of India
	<hr/>	(California)
	\$172,315	<hr/> \$27,857
Indonesia		
Bank Dagang Negara b	\$281,930	
P.T. Bank Niaga b	189,674	
	<hr/>	
	\$471,604	
Iran		
Bank Melli Iran b	\$3,369	
Israel		
Bank Hapoalim, B.M. d	\$229,698	
Bank Leumi le-Israel d	249,520	
Israel Discount Bank, Ltd. b	61,484	
United Mizrahi Bank, Ltd. d	105,148	
	<hr/>	
	\$645,850	

**TOTAL ASSETS OF FOREIGN BANKS WITH REPRESENTATION
IN CALIFORNIA BY COUNTRY OF ORIGIN**
(State Chartered only)
(In thousands of dollars)

<i>Name of Bank (by Country of Origin)</i>	<i>Total Assets Agency/Branch</i>	<i>Total Assets California Corporate Subsidiary</i>
Italy		
Banca Commerciale Italiana a	\$129,098	
Banca Nazionale del Lavoro b	187,237	
Banco di Roma b	1,537,394	
Banco di Sicilia b	170,378	
Credito Italiano b	111,412	
Istituto Bancario San Paolo di Torino		1,050,640 First Los Angeles Bank
	<u>\$2,135,519</u>	<u>\$1,050,640</u>
Japan		
Bank of Tokyo, Limited (The) a	\$2,924,016	\$15,959,550 Union Bank
Bank of Yokohama, Ltd. (The) b	312,832	
Chiba Bank, Ltd. (The) b	52,736	
Chuo Trust and Banking Company, Ltd. (The) b	738,821	
Daiwa Bank, Ltd. (The) a	1,636,510	
Dai-ichi Kangyo Bank, Ltd. (The) b	5,131,293	503,415 Dai-ichi Kangyo Bank of (California)
Fuji Bank, Ltd. (The) a	5,661,802	
Hokkaido Takushoku Bank, Ltd. (The) a	622,194	
Industrial Bank of Japan, Ltd. (The) b	9,091,119	
Kyowa Bank, Ltd. (The) a	1,125,906	102,099 Kyowa Bank of California
Long-Term Credit Bank of Japan, Ltd. (The) a	3,053,081	
Mitsubishi Bank, Ltd. (The) a	4,104,759	
Mitsubishi Trust and Banking Corp. (The) a	3,467,244	
Mitui Taiyo Kobe Bank, Ltd. (The) a	3,074,051	1,277,800 Mitui-Manufacturers Bank
Mitsui Trust and Banking Company, Ltd. (The) a	3,533,018	
Nippon Credit Bank, Ltd. (The) b	2,145,931	
Saitama Bank, Ltd. (The) a	894,725	
Sanwa Bank, Ltd. (The) a	3,402,623	7,062,143 Sanwa Bank of California
Shizuoka Bank, Ltd. (The) a	780,329	
Sumitomo Bank, Ltd. (The) a	4,434,113	4,429,585 Sumitomo Bank of California
Sumitomo Trust & Banking Company, Ltd. (The)	2,082,599	
Tokai Bank, Ltd. (The) a	5,055,235	1,196,870 Tokai Bank of California
Toyo Trust and Banking Company, Ltd. (The) a	1,243,691	
Yasuda Trust and Banking Company, Ltd. (The) a	4,298,133	
	<u>\$68,866,761</u>	<u>\$30,531,462</u>
Korea		
Bank of Seoul a	\$187,985	\$47,589 Seoul Bank California
Cho-Hung Bank (The) a	136,462	
Commercial Bank of Korea, Ltd. (The) a	266,514	

**TOTAL ASSETS OF FOREIGN BANKS WITH REPRESENTATION
IN CALIFORNIA BY COUNTRY OF ORIGIN**
(State Chartered only)
(In thousands of dollars)

<i>Name of Bank (by Country of Origin)</i>	<i>Total Assets Agency/Branch</i>	<i>Total Assets California Corporate Subsidiary</i>
Korea - (Continued)		
Hamil Bank, Ltd. (The) a	302,341	112,542 First State Bank of So. CA
Korea Exchange Bank a	529,434	424,224 California Korea Bank
Korea First Bank a	247,967	
	<hr/> \$1,670,703	<hr/> \$584,355
Luxembourg		
Bank of Credit & Commerce Int'l, S.A. b	\$75,696	
Malaysia		
Bank Bumiputra Malaysia Berhad b	\$37,055	
Mexico		
Banca Serfin, S.N.C. b	\$237,763	
Banco Nacional de Mexico b	39,024	\$484,842 California Commerce Bank
Bancomer, S.N.C. b	921,127	338,073 Grossmont Bank
	<hr/> \$1,197,914	<hr/> \$822,915
Netherlands		
Algemene Bank Nederland, N.V. b	\$85,394	
Philippines		
Allied Banking Corporation		\$62,907 Oceanic Bank
Manila Banking Corporation		22,979 Manila Bank California
Metropolitan Bank & Trust Company		126,173 International Bank of CA
Philippine Commercial & International Bank b	\$17,032	
Philippine National Bank e	17,085	66,887 Century Bank
	<hr/> \$34,117	<hr/> \$278,946
Singapore		
Development Bank of Singapore, Ltd. b	\$26,921	
International Bank of Singapore, Ltd. b	28,613	
Overseas Union Bank, Limited b	64,983	
Oversea-Chinese Banking Corporation b	1,691	
United Overseas Bank, Ltd. b	222,587	
	<hr/> \$344,795	

**TOTAL ASSETS OF FOREIGN BANKS WITH REPRESENTATION
IN CALIFORNIA BY COUNTRY OF ORIGIN**
(State Chartered only)
(In thousands of dollars)

<i>Name of Bank (by Country of Origin)</i>	<i>Total Assets</i>	<i>Total Assets</i>
	<i>Agency/Branch</i>	<i>California Corporate Subsidiary</i>
Spain		
Banco Bilbao Vizcaya b	\$341,640	
Banco Central, S.A. b	85,703	
Banco Exterior de Espana b	92,738	
	<hr/>	
	\$520,081	
Switzerland		
Credit Suisse e	\$217,880	
Swiss Bank Corporation e	392,827	
	<hr/>	
	\$610,707	
Taiwan		
Bank of Communications Co., Ltd. e	\$135,640	
First Commercial Bank (Inc. in Taiwan, R.O.C.) e	312,067	
Hua Nan Commercial Bank, Ltd. e	162,487	
	<hr/>	
	\$610,194	
Thailand		
Bangkok Metropolitan Bank b	\$32,895	
Thai Farmers Bank, Ltd. a	161,412	
	<hr/>	
	\$194,307	
United Kingdom		
Barclays Bank, plc b	\$599	
National Westminster Bank PLC b	91,544	
Royal Bank of Scotland (The) b	19,741	
Standard Chartered Bank plc e	39,059	
	<hr/>	
	\$150,943	
TOTAL - Foreign Countries	\$84,243,957	\$36,387,301

**TOTAL ASSETS OF FOREIGN BANKS WITH REPRESENTATION
IN CALIFORNIA BY COUNTRY OF ORIGIN**
(State Chartered only)
(In thousands of dollars)

<i>Name of Bank (by Country of Origin)</i>	<i>Total Assets Agency/Branch</i>	<i>Total Assets California Corporate Subsidiary</i>
<i>U.S. Territories</i>		
Guam		
Bank of Guam d	\$8,072	
Puerto Rico		
Banco Popular de Puerto Rico d	\$61,285	
TOTAL - U.S. Territories	\$69,357	
GRAND TOTAL	\$84,313,314	\$36,387,301
a Nondepository agency b Depository agency c Limited branch d Retail branch e Wholesale branch		

AS OF JUNE 30, 1990

For release on delivery
10:00 A.M. EDT
October 16, 1990

Testimony of
William Taylor
Staff Director, Division of Banking Supervision and Regulation
Board of Governors of the Federal Reserve System
before the
Committee on Banking, Finance and Urban Affairs
United States House of Representatives

October 16, 1990

Mr. Chairman, I appreciate the opportunity to testify on the role of the Federal Reserve in the supervision of foreign banks operating in the United States. The testimony of the Federal Reserve Bank of Atlanta discusses in some detail the actions taken by the Federal Reserve to deal with the problems at the Atlanta agency of Banca Nazionale del Lavoro (BNL). Therefore, I will focus more generally on the Federal Reserve's role in supervising the U.S. operations of foreign banks, referring to the BNL case to show how this authority was actually used in a particular situation.

The Federal Reserve's authority and responsibility for supervising the U.S. operations of foreign banks are derived primarily from two statutes, the Bank Holding Company Act and the International Banking Act of 1978 (IBA). Any foreign bank that owns a U.S. bank is subject to the Bank Holding Company Act. The IBA for the first time established federal jurisdiction over the U.S. operations of foreign banks that have branches or agencies in the United States, but do not own a U.S. bank, and applied certain provisions of the Bank Holding Company Act to these organizations. Thus, the IBA established an overall framework for regulating the full range of activities of foreign banks in the United States and provided for a federal role in the supervision of branches and agencies of foreign banks. Prior to the passage of the IBA, the operations of U.S. branches and agencies of foreign banks were licensed and supervised solely by state banking authorities.

Since I have been asked to focus on the supervision of branches and agencies, I will discuss principally the Board's

responsibilities under the IBA. However, the two Acts need to be looked at in tandem. For example, in addition to operating branches and agencies in the United States, BNL was a large issuer of commercial paper through a U.S. non-bank subsidiary. In the case of this company, the Federal Reserve's supervisory authority arose from the application by the IBA of part of the Bank Holding Company Act to BNL.

With the enactment of the IBA, Congress established a federal role in the licensing and supervision of branches and agencies of foreign banks that paralleled the federal government's role in the dual banking system. Foreign banks were given the option of establishing a banking office in the United States by obtaining either a federal license from the Office of the Comptroller of the Currency (OCC) or a license from one of the various states. The IBA permits multiple offices to be established using either state or federal licenses or both.

Federally licensed offices are supervised by the OCC and state licensed offices by the states. As is the case with banks, state licensed offices are also subject to some federal supervision, by the Federal Deposit Insurance Corporation (FDIC), if the branches have insured deposits, or the Federal Reserve for uninsured state licensed offices. It should be noted, however, that unlike banks, the vast majority of branches and agencies of foreign banks, including those of BNL, are not insured by the FDIC and do not accept consumer deposits.

Congress recognized at the time of enactment of the IBA, that many foreign banks already operated branches or agencies in a number of states, and that the trend of operating

under a number of different licenses could be expected to continue. Therefore, Congress determined that there should be one agency responsible for overseeing the totality of a foreign bank's operations in the United States. The Federal Reserve was given this umbrella supervisory authority. In order to carry out this responsibility, the Federal Reserve was given residual examination authority over all U.S. branches and agencies and the authority to obtain information from the foreign parent. The Federal Reserve also has the authority to undertake necessary supervisory actions against the foreign banking organization and its various U.S. offices.

Congress, nevertheless, instructed the Board to rely to the maximum extent possible upon the examinations conducted by the appropriate licensing authority and the FDIC. The Federal Reserve has made extensive use of the examination reports of other supervisors, and there is a high degree of cooperation and consultation among the various supervisory agencies at both the state and federal levels.

The Federal Reserve has exercised its authority by establishing a regular reporting system that covers all of the U.S. banking operations of foreign banks, working with the other supervisors to set examination standards, reviewing all examination reports of branches and agencies, obtaining information on the condition of the parent bank, meeting on a regular basis with the foreign banks operating in the United States, and taking enforcement actions where necessary. The Federal Reserve has also worked with the other federal bank regulatory agencies and the various states to establish a common

examination format and with their cooperation has sought to assure that each foreign branch or agency is examined at least once every eighteen months, a schedule that is basically being followed.

The Federal Reserve receives and reviews all examination reports conducted by the other federal and state bank supervisors. It collects and analyzes quarterly reports of condition and reports on foreign credit exposure from all branches and agencies of foreign banks. Through these and other means, the Federal Reserve tracks the condition of all U.S. offices of a foreign bank to assess the foreign bank's performance on a nationwide basis. The Federal Reserve also monitors the actions taken by other supervisors to require foreign banks to correct problems in particular offices, and undertakes enforcement or other corrective actions of its own where appropriate. In some cases, the Federal Reserve conducts examinations itself or participates in examinations conducted by other supervisory agencies. In the case of BNL it had been our practice to assign an examiner to the examinations conducted by the State of Georgia.

The Federal Reserve's direct role in the examination process varies from state to state. Its role depends on such factors as the importance of foreign banks in a particular state, the examination resources of the states, and the experience of the states in this area. For example, in California the Federal Reserve Bank of San Francisco and the state banking authority share the examination work load by each conducting examinations of particular offices in alternate years. In New York, on the

other hand, the examinations are currently conducted almost exclusively by the State of New York. In Texas the Federal Reserve Bank of Dallas conducts joint examinations with the state. Similarly, in other states various arrangements have been made depending on the circumstances. In some states with a very small foreign presence there is currently no direct Federal Reserve participation in the examination process.

The Federal Reserve also directly supervises the U.S. non-bank financial operations of foreign banks. Such activities require Board approval under the Bank Holding Company Act. In acting on such applications the Board reviews the condition of the foreign bank to make certain that it can be a source of strength to its U.S. operations. In addition, the Board reviews all of the existing U.S. operations of the foreign bank in an effort to assure that the overall operations of the foreign bank in the United States are in satisfactory condition.

Federal Reserve staff meets on a regular basis with the management of foreign banks operating in this country to discuss overall operations and to address problem areas. In addition, the Federal Reserve discusses problems with the home country supervisors.

It is important to keep in mind that branches and agencies are not U.S. banks. A branch or agency is an integral part of a foreign bank. The operations of the U.S. branches and agencies directly affect the condition of the whole bank and in turn are affected by developments at the head office and other branches. The Basle Concordat on supervising international banks recognizes this interdependence and emphasizes the responsibility

- 6 -

of the home country authority to supervise the foreign branches and agencies of its banks. The home country regulator is the authority most capable of supervising the overall solvency and activities of the foreign bank.

To summarize, in the BNL Atlanta case, the State of Georgia examined the Atlanta agency of BNL, with participation by the Federal Reserve. The Federal Reserve was further responsible for supervising the overall U.S. activities of BNL; and the Bank of Italy provided BNL with worldwide supervision.

I would now like to discuss how the Federal Reserve used its umbrella oversight authority in resolving the BNL problem in an orderly manner, and how it interacted with other supervisory authorities.¹ Let me say at the outset that once we became aware of the possible size of the illicit operations at BNL Atlanta, we recognized the potential for a significant disruption of banking markets. Therefore, cooperation among the authorities, both here and abroad, was essential in dealing effectively with this case.

As to the origin and growth of the illicit operations in BNL Atlanta, this was a situation that involved massive fraud

¹The Committee has requested information on the examination of U.S. offices of BNL and the Federal Reserve's role in those examinations. Since 1985, there have been 25 examinations of BNL's offices in the United States. Eight of these are Federal Reserve reports (including a joint report with the State of New York) and seventeen are state reports. Prior to the discovery of the recent fraud, the Atlanta office was examined every year by the State of Georgia with limited participation by the Federal Reserve Bank of Atlanta.

in which a large number of employees acted together to conceal the operation and deceive auditors and examiners. Books and records concerning the illicit operations were removed from the office by employees during examinations and audits. Much of the work associated with these transactions was conducted from employees' homes, and, of course, the office did not report the illicit activities on reports filed with the supervisory agencies.

The physical segregation of records, together with the concerted efforts of key employees, make it extremely difficult for examiners to uncover this type of illicit and fraudulent activity. Examiners also rely to a considerable extent on internal and external auditors. In the BNL Atlanta case, neither the internal auditors nor the large U.S. accounting firm conducting the external audit uncovered the large off-book lending and funding operation, although a 1988 audit report by the New York branch of BNL did criticize procedures at the Atlanta office.

Once the Federal Reserve became aware of the problem in BNL Atlanta, it initiated actions to determine the full scope of the problem, to assist federal law enforcement personnel, and to insure that the problem did not disrupt the financial system. After discussions with law enforcement personnel, a decision was made to have the Federal Bureau of Investigation (FBI) seize the records of the Atlanta office late in the day on Friday, August 4, 1989. The FBI agents were accompanied by Federal Reserve examiners who acted as technical advisors to the agents. The Federal Reserve also began an examination of the Atlanta agency

on that date. At approximately the same time, Federal Reserve examiners began examinations of the other U.S. offices of BNL and its commercial paper operation. State regulatory agencies were informed that these examinations had commenced and that there were problems in the Atlanta office of BNL.

Earlier in the week, the Federal Reserve informed the Bank of Italy that there was an urgent matter that the Federal Reserve needed to discuss. Senior Federal Reserve officials were dispatched to Rome to meet with officials of the Bank of Italy. The Bank of Italy was notified that it was likely that the Atlanta office of BNL had a large unreported business and that federal authorities were going to intervene on Friday, August 4. The Federal Reserve also advised the Bank of Italy of its concern that events might affect the dollar liquidity of BNL. The need for secrecy was emphasized so as not to jeopardize the seizure of the records by law enforcement personnel.

The Bank of Italy immediately undertook measures to make certain that the head office of BNL took appropriate actions once the seizure of the records was completed. The BNL official in charge of operations for the whole bank was sent to Atlanta arriving on Sunday, August 6. Other BNL personnel from Italy and New York were also immediately dispatched to Atlanta. BNL began marshalling dollar liquidity and transferring liquid dollar assets to the New York branch to meet any funding contingencies that might arise. The Bank of Italy closely supervised BNL's actions and dispatched its senior examination officers to Atlanta immediately.

To summarize, the Federal Reserve was able to use the supervisory authority conferred by the IBA to conduct simultaneous nationwide examinations of BNL's branches and agencies and to inspect its commercial paper subsidiary. These actions were taken on short notice and in a manner consistent with the need to maintain the secrecy necessary for the criminal investigation. The Federal Reserve was able to discuss the specific supervisory problem and its systemic implications with the Bank of Italy in order for Italian officials to make certain that BNL had sufficient dollar liquidity to service all of its dollar liabilities. I might note that no Federal Reserve funds were advanced to BNL. Through the Bank of Italy, the Federal Reserve was able to insure that BNL acted promptly to place new management in the Atlanta office and to contain the problem.

Once initial actions were taken, the Board worked with the Bank of Italy and state examination agencies to document the full scope of the problem and to identify the weaknesses in BNL's internal controls that enabled the illicit operations to develop undetected. In cooperation with the Bank of Italy and state supervisory authorities, corrective actions for BNL's U.S. offices were identified and implemented. The Federal Reserve has also continued to provide assistance to federal law enforcement personnel when requested.

Mr. Chairman, you have asked what additional authority the Federal Reserve might need in this area. As the actions described above illustrate, the IBA and other statutes provide the Federal Reserve with the broad authority needed to supervise

- 10 -

the U.S. operations of foreign banks and to respond to potential crises. No further authority seems necessary in this area.

While audit and internal control standards can be improved as the result of lessons learned from the BNL experience, the operation of BNL Atlanta involved massive fraud accompanied by false entries on the agency's books and false reporting to the federal authorities. Good controls can generally defend against this type of fraud by a single individual or a few individuals, but when a number of people within an organization conspire to "cook the books" it becomes much more problematic. More intensive monitoring and audits will help, but it is also important to deter this type of activity by successful prosecution and punishment of those involved.

In this regard it has come to our attention that some of the federal laws related to fraudulent actions in banks of the type involved in this case are not applicable to uninsured state licensed branches and agencies of foreign banks. The Federal Reserve believes that this situation should be corrected and has already furnished your Committee with proposed legislation in this area. I would urge that such legislation be promptly adopted.

This is not to say, however, that examination procedures can remain static. Over the past few years the Federal Reserve has been increasing its role in the supervision of branches and agencies as these entities have become more important factors in the U.S. banking market. The testimony of the Federal Reserve Bank of Atlanta describes how that Reserve bank has increased its examination efforts in Florida and

Georgia, two states in which the presence of branches and agencies of foreign banks has grown rapidly. The Federal Reserve Bank of New York is increasing its examination resources to enable it to expand its role as well. In addition, state authorities have taken actions to increase their ability to supervise branches and agencies of foreign banks. A special committee has been established under the auspices of the Conference of State Bank Supervisors to review state policies and to increase cooperation in this area among supervisors. The Federal Reserve has met with members of this committee to discuss examination matters of mutual interest. There are plans next year to have concurrent examinations of all of the U.S. branches and agencies of a select group of large foreign banks to determine if there are significant benefits to be derived from this type of examination format. In the international context, the Basle Committee on Banking Supervision has discussed the BNL case and its implications for the supervision of banks operating internationally.

The Federal Reserve intends to monitor closely the effectiveness of all of these efforts in view of the growing presence of foreign banks in U.S. financial markets. Historically, as you are no doubt aware, the principal focus of U.S. regulators has been on insured U.S. institutions given the presence of the federal safety net and the potential liability represented by the existence of federal deposit insurance. As the role of foreign banks in our markets evolves, however, we need to continually review the adequacy of the resources devoted to supervising these entities. The Federal Reserve will continue

- 12 -

to work closely with the other federal and state regulators to ensure an adequate supervisory framework for foreign banks in this country. If necessary and appropriate, we will not hesitate to propose and adopt further steps to strengthen federal oversight of the U.S. activities of foreign banks.

This concludes my testimony. I am prepared to answer questions you might have on the Federal Reserve's supervisory role.

UNITED STATES-IRAQ BUSINESS FORUM

MEMBERSHIP LIST - JULY, 1990

A.M.E. INTERNATIONAL, INC.
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 AMERICAN CAST IRON PIPE CO.
 AMERICAN IRAQI FINANCE & TRADE
 AMERICAN RICE, INC.
 AMOCO CORPORATION
 ANODYNE, INC.
 ARABIAN NATIONAL SHIPPING
 CORPORATION
 ARTHUR ANDERSEN & COMPANY
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 TOOLS, INC.
 THE BANK OF NEW YORK
 BANKERS TRUST COMPANY
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 PRODUCTION DIVISION
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 MOBIL OIL CORPORATION
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 NORWICH EATON PHARMACEUTICALS INC.
 OBELISK CORPORATION
 OCCIDENTAL INTERNATIONAL
 EXPLORATION & PRODUCTION CO.
 OHRA CORPORATION
 PEPSICOLA INTERNATIONAL
 CHARLES PERCY & ASSOCIATES
 PETROLITE CORPORATION
 PHILIP MORRIS INTERNATIONAL
 POWER MARKETING GROUP, INC.
 RIEDEL INTERNATIONAL, INC.
 SERVAAS, INC.
 SMI/SNEED-McBRIDE INTERNATIONAL, INC.
 SMITH METER INC.
 TABIKH INTERESTS, INC.
 TELETEC CORPORATION
 TELWAR INTERNATIONAL, INC.
 TEXACO, INC.
 UNITED TECHNOLOGIES CORPORATION
 UNOCAL CORPORATION
 VALMONT INDUSTRIES, INC.
 WESTINGHOUSE ELECTRIC CORPORATION
 WOODHOUSE, DRAKE & CAREY (TRADING)
 XEROX

Testimony for the Committee on Banking,
Finance and Urban Affairs of the
U.S. House of Representatives
Oct. 19, 1990 at 9:30 a.m.

The United States Iraq Business Forum is a trade association of United States companies who had a common interest in doing business with Iraq. It is a tax exempt non-profit corporation organized under Section 501(c)6 of the Internal Revenue Code. In July, 1990, it had a membership of 75 companies, including a number of America's largest corporations. The Board of Directors included representatives from Mobil, Amoco, Westinghouse, General Motors, Caterpillar, and City Bank of Texas. The Forum is supported solely by dues from its member companies. It has received no money from the Iraqi government, Iraqi companies, or Iraqi individuals.

The Forum was founded in 1985 for the purpose of promoting United States exports to Iraq. It organized a trade mission to Iraq, hosted receptions for visiting Iraqi officials to which representatives of member companies were invited, assisted member companies in obtaining visas and making the proper business contacts in Iraq, and conducted seminars on doing business in Iraq. It published a quarterly bulletin and other information on Iraq for distribution to member companies. Membership dues were \$5,000 per year for the larger companies and \$2,500 per year for the smaller ones. A list of member companies as of July 1990 is enclosed.

The Forum suspended all activities related to the promotion of trade with Iraq on Aug. 2, 1990.

United States Iraqi Commerce has increased steadily since the restoration of diplomatic relations between the United States and Iraq in 1984. The principal constraint on exports to Iraq has been the cash flow squeeze suffered by Iraq as a result of the eight year war with Iran. In 1988, the Iraqis estimated that they could clear up the debt created by the war in five to seven years and could then return to their previous practice of paying cash for all imports. In the meantime they asked for two years credit terms on most of their imports. Private bank credit for Iraq became increasingly difficult to find and exports to Iraq were, for practical purposes, limited to transactions eligible for government export credit guarantees or to the relatively few high priority items for which the Iraqis were willing to pay cash.

In the longer run Iraq appeared to be an excellent future market for the United States. The regime had ambitious plans for economic development and had a high regard for United States technology and capital goods. They have the natural resource required for balanced development of industry and agriculture. They also have the second largest reserves of crude oil in the Middle East which could provide the capital needed to finance their development plans.

In 1989, approximately two-thirds of U.S. exports to Iraq were agricultural commodities. The other one-third included a variety of consumer goods and capital goods such as pharmaceutical products, construction materials, automotive spare parts, and water pipe. The agricultural commodities were financed by the credit guarantee programs of the Commodity Credit Corporation of the Department of Agriculture. In addition, the Export/Import Bank's Foreign Credit Insurance Association (FCIA) provided a \$200 million line of short term credit insurance for exports to Iraq. The FCIA credit insurance was limited to credits of one year or less. In a relatively few cases, exporting companies accepted delayed payment terms of one or two years on their own account. There were also a few transactions financed by European banks without credit guarantees but at extremely high rates of interest. Very few U.S. banks were willing to confirm Iraq's letters of credit or extend credit to Iraq without credit guarantees. Some high priority items were purchased by Iraq for cash.

The business and financial community viewed Iraq as a potentially important trading partner for the United States. Iraq's banking system and its payments record were considered excellent prior to the Iraq-Iran war. After the war began in 1980, Iraq first drew down its substantial reserves but by 1982 payment problems began to develop. These were exacerbated in 1985 when the price of crude oil declined sharply.

At this time Iraq negotiated a series of bilateral debt rescheduling agreements with individual countries, but refused to engage in a multi-lateral rescheduling exercise, apparently in the belief that Iraq had more leverage in bilateral negotiations. The international banking community, however, viewed Iraq's behavior as discrimination between creditors, and private bank credit for Iraq became increasingly difficult to find. Iraq's leadership, on their side, believed that the western world was not sufficiently appreciative of Iraq's costly efforts in checking Iranian aggression into the oil rich areas to the west of the Gulf. They believed that they would be able to obtain government guaranteed credits which, when combined with their substantial oil export earnings, would give them enough foreign exchange to work their way out of their cash flow squeeze without multi-lateral rescheduling.

The Iraqis have never released official figures on their debt, but it has been estimated at approximately \$80 billion dollars of which approximately \$35 billion is in the form of "hard" debt to trading partners in Europe, Asia, and the United States which will need to be repaid. The balance is "soft" debt to the oil exporting Arab states pursuant to loans which most analysts believe were understood by all parties as "de facto" grants which will never be repaid.

In 1990, Iraq's cash flow situation worsened as oil prices dropped and western governments became increasingly

reluctant to provide credit guarantees for loans to Iraq. The Iraq leadership apparently began to believe that Kuwait was conspiring with the United States and other Western governments to damage the Iraqi economy. They could not understand why a rich country like Kuwait would exceed its OPEC quota and drive down the price of oil unless it had a hostile intent towards Iraq.

The U.S. decision to suspend the issuance of CCC credit guarantees for Iraq in January, 1990, probably added to their suspicions of a hostile conspiracy. These suspicion were probably a factor in their final decision to invade Kuwait.

The Iraq government prohibited foreign investment in Iraq except by nationals of other Arab countries. During the past two or three years, Iraqi government officials have indicated that the law might be waived on a case by case basis for joint ventures with American firms. To my knowledge no such joint venture has been formed. Some American companies may still have machinery or equipment in Iraq which was sent there to carry out turn key or construction projects. There is, however, no significant American equity investment in Iraq.

In my opinion, the U.S. government's commercial policies toward Iraq prior to the invasion of Kuwait were prudent. We did not give Iraq foreign aid nor did we sell Iraq arms or ammunition throughout their long war with Iran even

during periods when it appeared that Iran might win the war. Our Commodity Credit Corporation and Ex-Im Bank programs were designed to help American exporters reach an important market -- not to help Iraq.

Iraqi assets in the U.S. and most other countries are now frozen and Iraq has in turn, suspended payments on its foreign debt. The U.S. government will now need to make good on its credit guarantees but it is still possible that a resolution of the Gulf crisis will lead to negotiations and a mutually satisfactory settlement of these claims.

However the current crisis is resolved, Iraq will emerge as an important economic factor in the Middle East. It has the land, the water, the resources and the infra-structure required for rapid development and has the oil reserves needed to pay the bills. The population is relatively well educated and Iraqis have a high regard for American technology and management. In brief, there is a natural "fit" between the U.S. and Iraqi economies that would permit a mutually beneficial commercial relationship between our two countries when and if we decide that such a relationship should be resumed.

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U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS
 2129 RAYBURN HOUSE OFFICE BUILDING
 WASHINGTON, DC 20515

September 24, 1990

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(202) 225-4247

Mr. L. William Seidman
 Chairman
 Federal Deposit Insurance Corporation
 550 17th Street N.W.
 Washington, D.C. 20429

Dear Chairman Seidman:

The Committee on Banking, Finance and Urban Affairs will hold a hearing on the regulation of U.S. branches and agencies of foreign banks on October 9, 1990, at 9:30 a.m. in Room 2129 Rayburn House Office Building. You or your designee are invited to testify at that hearing.

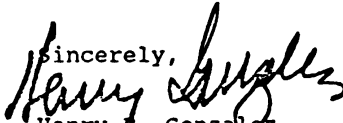
- 1) What is FDIC's role regarding the U.S. branches and agencies of foreign banks?
- 2) Regarding the regulation and examination of these entities, please explain the coordination that occurs between the 50 states, the Office of the Comptroller of the Currency (OCC), the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC).
- 3) Please provide financial information on FDIC-insured U.S. branches and agencies of foreign banks including the number of such entities, aggregate balance sheet and income statement data, number of branches and agencies and their total employees.
- 4) What percentage of the aggregate liabilities of these entities is insured by the FDIC?
- 5) Please explain the FDIC's role in regulating the U.S. branches and agencies of foreign banks. How often are these entities examined by the FDIC? How many examiners does the FDIC have specifically dedicated to examining these entities? What type of examination does the OCC conduct (i.e. safety and

- 5) Does the State of Georgia exercise adequate supervision over the activities of U.S. branches and agencies of foreign banks?
- 6) Is the regulatory structure governing the U.S. branches and agencies of foreign banks adequate or is the fragmented structure that now exists (i.e., the regulation and examination of these entities is divided among the OCC, FDIC, and Federal Reserve as well as the 50 States) prone to breakdowns such as the one that occurred in the BNL-Atlanta case?
- 7) Do you have any recommendations for improving or streamlining the regulation and examination of these entities? Do you have any suggestions for improving coordination between the state banking agencies and the federal bank regulatory agencies?

Committee rules require your testimony be made available to Members twenty-four hours in advance of a hearing. Please deliver 50 copies of your written response to these questions to Room 2129 Rayburn House Office Building by 9:30 a.m., October 8, 1990. You will be given 10 minutes to summarize your testimony at the beginning of the hearing.

Thank you for your time and consideration of this request. The Committee looks forward to your testimony.

With best wishes.

Sincerely,

Henry B. Gonzalez
Chairman

HBG:dk

**Office of the Attorney General**

Washington, D.C. 20530

September 26, 1990

The Honorable Henry B. Gonzalez
Chairman
Committee on Banking, Finance,
and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The purpose of this letter is to express my profound disappointment in your decision to ignore the strong objections of this Department in the Banca Nazionale del Lavoro (BNL) matter. I am similarly distressed by your refusal last evening to discuss the matter with me.

Your intention to schedule a hearing for October 9th on the investigation of unauthorized loans to Iraq by BNL and the request to interview both the Assistant United States Attorney and the government witnesses in the case raises the prospect that culpable parties will elude prosecution. Your staff is fully aware of the existence of our ongoing criminal investigation and the likely impact that these actions will produce on our efforts.

As you should be aware, this is a sensitive case with national security concerns. The United States Attorney in Atlanta advises me that both witness security and the willingness of witnesses to continue to cooperate with the investigation and prosecutions will be jeopardized by your Congressional staff interviews and hearing.

Mr. Chairman, a decision to proceed with these interviews and the hearing at this time significantly diminishes the Department's ability to successfully prosecute this matter. Accordingly, we again request that your staff work with the Department to find alternatives that allow both the legislative and the law enforcement processes to function.

Sincerely,



Dick Thornburgh
Attorney General

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BIL FAXON, NEW YORK

(202) 225-4247

September 28, 1990

Honorable Richard L. Thornburgh
Attorney General
Washington, D.C. 20530

Dear Mr. Attorney General:

The purpose of this letter is to respond to your letter of September 26, 1990, and to express my distress over your apparent lack of understanding of the investigative and legislative functions of the Congress.

On September 21, 1990, I agreed to allow my staff to meet with your staff to discuss the Justice Department's concerns related to the Banking Committee's investigation of the Atlanta Agency of Banca Nazionale Del Lavoro (BNL). During, and subsequent to this meeting, your staff was unable to comply with my request for specific justification for suspending this most important inquiry.

Specifically, the Justice Department failed to reveal how interviewing employees from the Federal Reserve Board, the Federal Reserve Bank of Atlanta, the Department of Banking and Finance of the State of Georgia, and current and former employees of BNL would, as your letter states, "significantly diminish the Justice Department's ability to successfully prosecute this matter." In addition, the Justice Department failed to demonstrate how the Banking Committee's investigation would jeopardize the personal security of witnesses or inhibit their cooperating with the Justice Department's investigation of BNL.

As Chairman of the Banking Committee, I am concerned that the regulation and examination of the U.S. branches and agencies of foreign banks (see the International Banking Act 92 Stat. 607) is inadequate. These entities command over \$500 billion in assets in the U.S., and a significant portion of their liabilities are guaranteed by the Federal Deposit Insurance Corporation (FDIC). The magnitude of the BNL fiasco (i.e., \$2.8 billion in unauthorized loans to Iraq), while not directly posing a risk to the FDIC, certainly raises the question of the adequacy of state and federal regulation and oversight of these entities. Rest assured, in

order to ensure the U.S. branches and agencies of foreign banks do not pose an undue risk to the already beleaguered FDIC, the Banking Committee will continue to investigate the adequacy of the regulation and examination of these entities. The BNL case provides a clear case of a regulatory breakdown that needs to be understood and addressed.

With regard to the Banking Committee's legislative interest in BNL, the Federal Reserve has notified me that the BNL investigation uncovered a loophole in the criminal code that will probably allow former employees of BNL to escape Federal prosecution for fraud, theft, embezzlement, misapplication of funds, and bribery. You can be sure that I will continue to work to correct this over decade long Justice Department oversight. I have been given permission by the Rules Committee, and I intend to offer, a Floor amendment to the crime bill that will close this loophole in the criminal code.

I hope this letter has served to properly inform you as to the Banking Committee's legislative and investigative interests in BNL. I trust the Justice Department will provide its full cooperation.

Sincerely,


Henry B. Gonzalez
Chairman

HBG:dk



U.S. Department of Justice

Federal Bureau of Investigation

Office of the Director

Washington, DC 20535

October 5, 1990

Honorable Henry B. Gonzalez
Chairman
Committee on Banking, Finance,
and Urban Affairs
U. S. House of Representatives
Washington, D. C. 20515

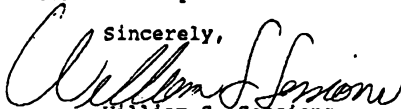
Dear Mr. Chairman:

The purpose of this letter is to express my concern with the Banca Nazionale del Lavoro (BNL) matter. I have been informed that your Committee plans to hold an open meeting on Tuesday, October 9, 1990, on the BNL investigation with the intention of voting on issuing subpoenas for documents and individuals. I also understand that you intend to hold a hearing on these matters on October 16, 1990.

Mr. Chairman, you should be aware of the existence of an ongoing criminal investigation into these matters and the likely negative impact that the Committee's actions could have on this investigation. Among my concerns are the possibility of grand jury information being inadvertently disclosed in your proceedings or other statements or evidence being disclosed prior to the anticipated trial. I am similarly concerned that the Committee's actions may prevent both further cooperation by witnesses and in fact may pose a serious threat to witness security or jeopardize successful prosecution.

I regret that we did not have the opportunity to discuss these matters today. I hope that we can work together to prevent serious damage to a very sensitive and important case.

Sincerely,



William S. Sessions
Director

JEC:aga



RALPH ABRAHAM, ALABAMA
 WALTER E. FAHNEY, DISTRICT OF COLUMBIA
 STEPHEN L. HENL, NORTH CAROLINA
 CARROLL HUBBARD, JR., KENTUCKY
 JOHN J. LAMARCA, NEW YORK
 MARY ROSE BAKER, OHIO
 BRUCE F. VERNER, MINNESOTA
 DONALD BARBARO, A. GEORGIA
 ROBERT GARCIA, NEW YORK
 CHARLES E. SCHLESER, NEW YORK
 BARNEY FRANK, MASSACHUSETTS
 RICHARD H. LIPKIN, CALIFORNIA
 BRUCE A. MORRIS, CONNECTICUT
 MARY CAULIN, OHIO
 BEN BROWDER, ALABAMA
 THOMAS H. CARPER, DELAWARE
 LESTER EDWARDS TORRES, CALIFORNIA
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 BILL NELSON, FLORIDA
 PAUL E. SANJORNIO, PENNSYLVANIA
 ELIZABETH A. PATTERSON, SOUTH CAROLINA
 THOMAS MICHELLER, MARYLAND
 JOSEPH F. LEBESKY, MASSACHUSETTS
 FLOYD R. PLACE, NEW YORK
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 DAVID L. PRICE, NORTH CAROLINA
 MARY FIELDS, CALIFORNIA
 JIM MACDONOTT, WASHINGTON
 PETER HODGKINS, NEBRASKA
 RICHARD E. HENL, MASSACHUSETTS

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS

2129 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515

August 23, 1990

NORMAN D. BLOOMBERG, CALIFORNIA
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005 225-4247

Robert L. Clarke
 Comptroller of the Currency
 Office of the Comptroller
 of the Currency
 Washington, D.C. 20219

Dear Mr. Clarke:

During your testimony before the House Banking Committee on August 9, 1990, I briefly mentioned that I would be writing you to get additional information on the U.S. branches and agencies of foreign banks. I would be most appreciative if you could answer the following questions regarding this issue.

- 1) What is OCC's role regarding the U.S. branches and agencies of foreign banks?
- 2) Regarding the regulation and examination of these entities, please explain the coordination that occurs between the Office of the Comptroller of the Currency (OCC), the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC).
- 3) Please provide financial information on the federally-chartered U.S. branches and agencies of foreign banks including aggregate balance sheet and income statement data, number of branches and agencies and their total employees.
- 4) How many of these entities are insured by FDIC? What percentage of the aggregate liabilities of these entities are insured by the FDIC?
- 5) How often are these entities examined by the OCC? How many examiners does the OCC have specifically dedicated to examining these entities?
- 6) Please explain the enforcement authority of the OCC as it pertains to the U.S branches and agencies of foreign banks.

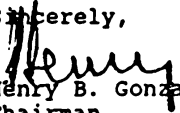
- 7) Are federally-chartered U.S. branches and agencies of foreign banks subject to criminal penalties such as bank fraud, embezzlement, false bank entries, misapplication of funds, and bribery as enumerated under Title 18 of the U.S. Code? Please explain.

Thank you for your time and consideration of this request. If you have any questions regarding this request, please feel free to contact Mr. Dennis Kane of my staff at (202) 225-4247.

Your cooperation is most appreciated, and I look forward to your timely reply.

With best wishes.

Sincerely,


Henry B. Gonzalez
Chairman

HBG:dk



Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

October 1, 1990

The Honorable Henry B. Gonzalez
Chairman
Committee on Banking, Finance and Urban Affairs
United States House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

I am replying to your request for information concerning U. S. branches and agencies of foreign banks. As you know, the Comptroller of the Currency (OCC) is the primary bank regulatory agency for Federal branches and agencies established by foreign banks. In order to assure a complete response, our reply addresses each of your questions in turn.

1. What is the OCC's role regarding the U. S. branches and agencies of foreign banks?

The passage of the International Banking Act of 1978 (IBA) afforded foreign banks the opportunity to apply for a Federal branch license in those states in which the bank was not operating a State branch pursuant to State law and the establishment of a branch or agency, as the case may be, is not prohibited by State law. In short, the IBA affords foreign banks a Federal branch alternative in those states that do not prohibit foreign bank entry on a branch or agency basis. The IBA identified the OCC as the U. S. bank regulatory agency charged with primary responsibility for supervising Federal branches and agencies. The OCC is responsible for acting on all applications to license Federal branches, performing examinations and providing an overall program of supervision to assure safety and soundness of operations.

2. Regarding the regulation and examination of these entities, please explain the coordination that occurs between the Office of the Comptroller of the Currency (OCC), the Federal Reserve

and the Federal Deposit Insurance Corporation (FDIC).

In the regulation of Federal branches, the OCC, the Federal Reserve, and the FDIC shoulder the same responsibilities as they do with the national banking system. The OCC, as the primary supervisor of Federal branches, shares information with the Federal Reserve and FDIC regarding such things as requirements of the Bank Holding Company Act, bank reserves, and insurance of deposits. Beyond this, all three regulatory agencies are empowered under the IBA to issue such rules, regulations and orders as each of them may deem necessary in order to perform their respective duties and functions as bank regulators. As the primary supervisor of Federal branches, our position has always been to prevent duplication of effort by sharing information with the Federal Reserve and FDIC and assisting them in the fulfillment of their responsibilities as well as our own.

3. Please provide financial information on the federally-chartered U. S. branches and agencies of foreign banks including aggregate balance sheet and income statement data, number of branches and agencies and their total employees.

At present, there are 80 Federal branches in operation in three states (New York, California, and Illinois). By far, the majority of Federal branches are located in New York City although several are located on the west coast. A single Federal agency, Banco Colpatria, operates in Miami, Florida. In addition to those in operation, there is an approved but unopened Federal branch in Tucson, Arizona and four Federal branch applications in process. One Federal branch, Union Bank of the Middle East, Ltd. is undergoing voluntary liquidation. Enclosed is an up-to-date listing of the current licensees giving name, location, license number, special powers, and other corporate information.

As of June 30, 1990, the 81 Federal licensees had approximately \$33.3 billion in total assets, \$13.1 billion in total loans, and \$14.9 billion in total deposits. Total liabilities to non-related third parties amounted to \$29.3 billion. Income information for our licensees is something which we do not collect or monitor in the same way as balance sheet information because Federal branches, despite their "stand alone" status under the IBA, are simply branch offices of a larger parent institution. Many Federal branches are subject to managed profitability by the parent bank (i.e. funded and managed to break-even profitability or, perhaps, even to show a loss on operations). For these reasons, income information is not collected by the Federal branch call report (FFIEC 002) or included as a component in the regulatory ratings (AIM)

assigned by the OCC. Likewise, the total number of employees at Federal branches is operational information which the OCC does not collect; however, we believe it varies considerably from branch to branch based upon size and scope of operations.

4. How many of these entities are insured by the FDIC? What percentage of the aggregate liabilities of these entities are insured by the FDIC?

As indicated by the list enclosed, only seven Federal branches are insured by the FDIC. The small number covered by deposit insurance reflects the fact that most Federal branches are not retail banking operations. Most Federal branches are of a wholesale nature and oriented to international trade and commerce. For the most part, those Federal branches that are FDIC insured also serve sizeable ethnic markets comprised of people who have migrated from the home country of the parent bank. In the aggregate, the seven Federal branches insured by the FDIC had total deposits of approximately \$758 million as of June 30, 1989. This represents approximately 5% of the deposit liabilities of all Federal branches.

5. How often are these entities examined by the OCC? How many examiners does the OCC have specifically dedicated to examining these entities?

The IBA requires the OCC to perform an examination of each Federal branch at least once each calendar year. The OCC does not have a cadre of examiners with exclusive responsibility for Federal branches. Rather, the first line responsibility for examination and supervision of the various Federal branches rests with an OCC examiner and is part of his or her assigned portfolio of banks. The number of examiners at any one time assigned to the examination of Federal branches depends upon a number of factors including scope of the examination and previously identified problem areas. We examine Federal branches the same way we examine national banks making use of the same resources and regulatory expertise.

The entire program of Federal branch examination and supervision is administered by the Multinational Banking Department of the OCC located in Washington, D. C. Multinational Banking is responsible for the processing of all Federal branch applications, program administration and operation, policy formulation, and oversight of examination and supervision. Multinational Banking works to ensure the examination and supervision of Federal branches is consistent with both the IBA and national treatment.

6. Please explain the enforcement authority of the OCC as it pertains to the U. S. branches and agencies of foreign banks.

The IBA empowered the OCC with the authority to issue such rules, regulations, and orders as deemed necessary to carry out its functions and the purposes and provision of the IBA. We have the same enforcement tools available with respect to Federal branches as we do for national banks. Civil money penalties, cease and desist orders and other enforcement measures are available and have been used as enforcement and compliance tools. In addition, the OCC has the authority under the IBA to terminate the license of a Federal branch for noncompliance with any rule, order or regulation. This tool remains an ultimate sanction for extreme cases.

7. Are federally-chartered U. S. branches and agencies of foreign banks subject to criminal penalties such as bank fraud, embezzlement, false bank entries, misapplication of funds, and bribery as enumerated under Title 18 of the U. S. Code? Please explain.

National treatment of Federal branches and agencies is manifested by the IBA in a number of ways. The IBA creates similar liabilities and responsibilities as the National Bank Act. The IBA states, in part, at 12 USC 3102 (b), "operations of a foreign bank at a Federal branch or agency shall be conducted with the same rights and privileges as a national bank at the same location and shall be subject to all the same duties, restrictions, penalties, liabilities, conditions, and limitations that would apply under the National Bank Act to a national bank doing business at the same location."

I appreciate the opportunity to share the foregoing information with you. Should you or any member of your staff require additional information or need clarification of any of the points discussed, please do not hesitate to contact my office.

Sincerely,



Robert L. Clarke
Comptroller of the Currency

Enclosure

<u>Northeastern District</u>		<u>Home State</u>
Mr. Assaad S. Assaad 202/842-7950 President & Managing Director Abu Dhabi International Bank, Inc. 1776 G Street, N.W. Washington, D.C. 20006 Opened 1-30-81	#16	DC Curacao, Netherlands
Dr. G.J.M. Vlak 212/838-7300 General Manager Amsterdam-Rotterdam Bank N.V. 500 Park Avenue New York, NY 10022 Opened 7-15-81	#24	NY Amsterdam, Netherlands
Mr. Dale A. Doll 212/850-0600 General Manager Arab Banking Corporation B.S.C. 245 Park Avenue New York, NY 10167 Opened 9-14-81	#26	NY Manama, Bahrain
Dr. M.A. Rahal 212/715-9700 Executive Vice President Arab Bank Ltd. 520 Madison Avenue New York, NY 10022 Opened 1-3-83	#56	NY Amman, Jordan
Mr. Michael A. Cancilla 212/820-9800 Senior Vice President Australia & New Zealand Banking Group Ltd. 120 Wall Street New York, NY 10005 Converted 7-14-80	#4	NY Melbourne, Australia
Mr. Anthony Franco 212/758-5040 General Manager Banca Popolare di Milano 375 Park Avenue New York, NY 10022 Opened 11-4-83	#73	NY Milan, Italy
Mr. Anthony Pain 212/644-6460 General Manager Banco Bamerindus do Brazil S.A. 745 5th Avenue New York, NY 10151 Opened 10-15-82	#50	NY Curitiba, Brazil

Mr. Wang Xuebing 212/935-3101

General Manager

Bank of China

410 Madison Avenue

New York, NY 10017

Opened 9-18-81 & 9-26-85

#28 & #91

NY

People's Rep. of China

42-44 East Broadway

New York, NY 10002

(FDIC Insured)

Mr. Roderick Richards 212/980-0510

Executive Vice President

Bank of East Asia Ltd.

450 Park Avenue

New York, NY 10022

Opened 5-1-84

#81

NY

Hong Kong, B.C.C.

Mr. Chan Kai Karp

Branch Manager

Bank of East Asia Ltd.

185 Canal Street

New York, NY 10013

Opened 3-27-89

#97

NY

Hong Kong, B.C.C.

(FDIC Insured)

Mr. Robin P. Tuckey 212/984-1400

Vice President & Deputy Manager

Bank of New Zealand

575 Park Avenue, 38th Floor

New York, NY 10017

Opened 2-22-82

#37

NY

Wellington, New Zealand

Mr. Howard H. McHattie 212/490-8030

Executive Vice President

Bank of Scotland

380 Madison Avenue

New York, NY 10017

Opened 5-26-81

#21

NY

Edinburgh, Scotland

Mr. Jean-Louis Recoussine 212/489-7000

General Manager

Bank Brussels Lambert, S.A.

630 5th Avenue

New York, NY 10111

Opened 1-4-84

#75

NY

Brussels, Belgium

Mr. Wilfried Freudenberger & Mr. Joachim Klose 212/310-9800

Senior Vice President & General Manager

Bayerische Landesbank Girozentrale

560 Lexington Avenue

New York, NY 10022

Opened 10-1-81

#30

NY

Munich, Germany

Mr. Ivar Haller 212/418-2205 General Manager Caisse Nationale de Credit Agricole 520 Madison Avenue New York, NY 10022 Opened 3-15-84	#77	(LFB) Paris, France	NY
Mr. Giorgio Cuccolo 212/980-0690 General Manager Cassa di Risparmio di Torino 500 Park Avenue New York, NY 10022 Opened 12-2-85	#92	Torino, Italy	NY
Mr. Norbert M. Tiedemann 212/207-2420 General Manager Commercial Bank of Kuwait SAK 350 Park Avenue New York, NY 10022 Opened 8-20-84	#88	Safat, Kuwait	NY
Mr. Abdallah Jadallah 212/ General Manager The Commercial Bank of Kuwait, S.A.K. 4201 Connecticut Avenue, N.W. Washington, DC 20008 Opened 10/10/89	#99	(LFB) Safat, Kuwait	NY
Mr. Adrian Tolver Walker 212/848-9200 Executive Vice President Commonwealth Bank of Australia 599 Lexington Avenue New York, NY 10171 Opened 7-1-81	#22	Sydney, Australia	NY
Mr. Marko Musulin & Mr. Frederick Hertel 212/308-6400 General Managers Creditanstalt-Bankverein 245 Park Avenue New York, NY 10167 Opened 4-4-83	#60	Vienna, Austria (Trust Powers)	NY
Mr. Syed Rafiuddin 212/509-4030 General Manager Doha Bank Ltd. 127 John Street New York, NY 10038 Opened 4-15-83	#63	Doha, Qatar	NY

Mr. Hans KriKava 212/286-3882
 General Manager
 Girozentrale Vienna
 Park Avenue Tower
 65 East 55th Street
 New York, NY 10022
 Opened 3-2-87

#94 Vienna, Austria NY

Mr. Brian W. Clark 212/303-3060
 Executive Vice President
 Gulf International Bank
 380 Madison Avenue, 21st Floor
 New York, NY 10017
 Opened 10-1-80

#10 Manama, Bahrain NY

Mr. Patrick Leung 212/608-0070
 General Manager
 Hang Seng Bank Limited
 27 East Broadway
 New York, NY 10002
 Opened 9-23-83

#69 Hong Kong, B.C.C. NY

(FDIC Insured)

Mr. Philip Hung
 General Manager
 Hang Seng Bank Limited
 268-270 Canal Street
 New York, NY 10013
 Opened 6-16-89

#98 Hong Kong, B.C.C. NY

(FDIC Insured)

Mr. Luigi Maranzana 212/750-7600
 Senior Vice President & General Manager
 Istituto Bancario San Paolo di Torino
 499 Park Avenue
 New York, NY 10022
 Converted 1-3-84

(LFB)
 #7 Turin, Italy CA

Mr. Edgar Pang 212/308-5500
 Vice President & Manager
 Ka Wah Bank Ltd.
 520 Madison Avenue, 38th Floor
 New York, NY 10022
 Opened 3-1-83

#58 Hong Kong, B.C.C. NY

Mr. Kovit Rojanasomsit 212/704-0001
 General Manager
 Krung Thai Bank Ltd.
 452 5th Avenue, 12th Floor
 New York, NY 10018
 Opened 9-3-82

#47 Bangkok, Thailand NY

Mr. William Wen Pal Yu 212/775-0927 Vice President & General Manager Metropolitan Bank & Trust Company 10 East 53rd Street New York, NY 10022 Opened 6-1-83	#66	NY Manila, Philippines	(FDIC Insured)
Mr. Sampath Kumar 212/557-2500 General Manager Middle East Bank Ltd. 330 Madison Avenue New York, NY 10017 Opened 12-7-81	#35	NY Dubai, United Arab Emirates	
Mr. John Dean 212/916-9501 Senior Vice President National Australia Bank Ltd. 200 Park Avenue, 34th Floor New York, NY 10166 Opened 10-21-80	#11	NY Melbourne, Australia	
Mr. George Y. Nasra 212/303-9800 General Manager National Bank of Kuwait S.A.K. 299 Park Avenue New York, NY 10171 Opened 9-19-84	#89	NY Safat, Kuwait	(Trust Powers)
Mr. Javaid A. Abbasi 212/462-7373 General Manager National Bank of Pakistan 1825 Connecticut Avenue, N.W. Washington, D.C. 20009 Opened 7-1-80	#3	(LFB) DC Karachi, Pakistan	
Mr. Camille A. Chebeir 212/916-9000 Acting General Manager National Commercial Bank 245 Park Avenue, 37th Floor New York, NY 10167 Opened 9-1-83	#68	NY Jeddah, Saudi Arabia	(Trust Powers)
Mr. Friedrich Heigl 212/593-0099 General Manager Osterreichische Landerbank Aktiengesellschaft 767 5th Avenue New York, NY 10153 Opened 7-1-87	#95	NY Vienna, Austria	

Mr. Hugo Steensma 212/916-7800
 Senior Vice President & General Manager #19 NY
 Rabobank Nederland Utrecht, Netherlands
 245 Park Avenue
 New York, NY 10167
 Opened 4-9-81

Mr. James M. Walker 212/407-9306 & 212/806-3119
 Senior Vice President & General Manager #72 & 71 NY
 The Royal Bank of Canada Montreal, Canada
 Financial Square & One Pierrepont Plaza
 New York, NY 10055 Brooklyn, NY 11201
 Opened 11-1-83 for both

Mr. James Strang Bell
 General Manager #101 NY
 The Royal Bank of Canada Montreal, Canada
 300 Pearl Street
 Buffalo, New York 14202
 Opened 2-1-90

Mr. David J. Hogan 212/355-6530
 General Manager #65 NY
 Saudi International Bank London, England
 520 Madison Avenue
 New York, NY 10022
 Opened 5-3-83

Mr. Cecil Fu 212/619-7070
 General Manager #61 (LFB) NY
 Shanghai Commercial Bank Ltd. Hong Kong, B.C.C.
 135 William Street
 New York, NY 10038
 Opened 4-8-83

Mr. John M. Bartholomew 212/682-1300
 Senior Vice President #45 NY
 State Bank of New South Wales Limited Sydney, Australia
 645 5th Avenue, 18th Floor
 New York, NY 10022
 Opened 7-8-82

Mr. Methee Pattarakornkul 212/432-0890
 Vice President & General Manager #8 NY
 Thai Farmers Bank Ltd. Bangkok, Thailand
 One World Trade Center, Suite 8373
 New York, NY 10048
 Opened 9-22-80

Mr. Ade Coker 212/308-7222
 General Manager
 United Bank for Africa Ltd.
 551 Madison Avenue
 New York, NY 10022
 Opened 5-1-84

#82 Lagos, Nigeria NY

Mr. Jerry Ford Steele 212/832-6700
 General Manager
 United Bank of Kuwait Ltd.
 126 East 56th Street
 New York, NY 10022
 Opened 9-29-83

#70 London, England NY
 (Trust Powers)

Mr. P.K. Bahri 212/688-9494
 General Manager
 Union Bank of the Middle East Ltd.
 560 Lexington Avenue
 New York, NY 10022
 Opened/Converted 3-1-82

#38 NY
 (IN LIQUIDATION)

Mr. Brian Howard 212/551-2700
 Senior Vice President
 Westpac Banking Corporation
 335 Madison Avenue, 27th Floor
 New York, NY 10017
 Opened 10-1-80

#9 Sydney, Australia NY

FA FEDERAL AGENCY
 FB FEDERAL BRANCH
 LFB LIMITED FEDERAL BRANCH

Mr. Sergio de Lima Conter 212/308-5400 General Manager Banco do Estado do Parana, S.A. 9 West 57th Street New York, NY 10019 Opened 3-8-83	#59	Curitiba, Brazil	NY
Mr. Carlos Roberto Becker 212/759-7887 General Manager Banco do Estado do Rio Grande do Sul, S.A. 500 Fifth Avenue, Suite 1238 New York, NY 10110 Opened 10-27-82	#52	Porto Allegre, Brazil	NY
Mr. Anthony J. Ellery Cavour 212/759-7878 General Manager Banco do Estado do Rio de Janiero, S.A. 500 Park Avenue New York, NY 10022 Opened 11-23-81	#34	Rio de Janeiro, Brazil	NY
Mr. Robert D. Azevedo 212/758-3700 General Manager Banco Economico, S.A. 499 Park Avenue New York, NY 10022 Opened 4-11-80	#1	Salvador, Brazil	NY
Mr. Carlos Garcia 202/466-7540 General Manager Banco Real, S.A. 1800 K Street, N.W. Washington, D.C. 20006 Opened 10-18-82	#51	(LFB) Sao Paulo, Brazil	DC
Mr. Chansak Fuangfu 212/422-8200 Vice President & Manager Bangkok Bank Ltd. 29 Broadway New York, NY 10006 Opened 4-2-84	#80	(LFB) Bangkok, Thailand	CA
Mr. David E. Bodner 212/949-9044 Senior Vice President & General Manager Bank Julius Baer Banking Corporation 330 Madison Avenue New York, NY 10017 Opened 4-2-84	#78	Zurich, Switzerland	NY

(Revised 9/14/90)

<u>Southeastern District</u>		Home State
Mr. Ernest Cordovez General Manager Banco Colpatria 848 Brickell Avenue, Suite 1200 A Miami, FL 33131 Opened 11-2-81	305/374-4026 #32	(FA) FL Bogota, Columbia
 <u>Central District</u>		 Home State
Ms. Joann F. Boulles Manager Australia & New Zealand Banking Group Ltd. 190 South LaSalle Street Chicago, IL 60603 Opened 7-6-81	312/236-6835 #23	(LFB) NY Melbourne, Australia
Mr. Henry Rodriguez-Trujillo Branch Manager Banco Popular de Puerto Rico 2525 North Kedzie Dr. Chicago, IL 60647 Opened 5-21-84	312/772-0010 #85	IL San Juan, Puerto Rico (FDIC Insured)
Mr. W. Les P. Savell Branch Manager Commonwealth Bank of Australia 30 South Wacker Dr., Suite 2806 Chicago, IL 60606 Opened 8-1-85	312/876-1200 #90	(LFB) NY Sydney, Australia
Mr. Edward V. Russell General Manager National Australia Bank Ltd. 303 West Madison St., 26th Floor Chicago, IL 60606 Opened 10-1-82	312/782-5960 #49	(LFB) NY Melbourne, Australia
Mr. Barry D. Bint Senior Vice President & Manager Westpac Banking Corporation 225 West Washington, 28th Floor Chicago, IL 60606 Opened 9-7-82	312/630-0170 #48	(LFB) NY Sydney, Australia

Western District

Mr. Rubin Gonzales Vice President Banco Internacional, S.N.C. 5255 Williams Circle, Suite 2080 Tucson, Arizona 95711 <u>Approved 5-16-89</u>	#()	Mexico City, Mexico
Mr. Lawrence Avilasakul 213/488-9170 Senior Vice President Bangkok Bank Ltd. 800 West 6th Street, Suite 1250 Los Angeles, CA 90071 Opened 4-2-84	#79	CA Bangkok, Thailand
Mr. Che Jun 213/688-8700 Branch Manager Bank of China 444 South Flower Street, 39th Floor Los Angeles, CA 90071 Opened 10-6-88	#96	(LFB) CA People's Rep. of China
Mr. Luan T. Le 415/398-3781 Senior Vice President Dah Sing Bank Ltd. 300 Montgomery Street, Suite 515 San Francisco, CA 94104 Opened 2-20-81	#18	(LFB) CA Hong Kong, B.C.C.
Mr. Walter On Chit Lam Branch Manager Hang Seng Bank Limited 555 Montgomery Street San Francisco, CA 94111 Opened 12/19/89	#100	(LFB) NY Hong Kong, B.C.C.
Mr. Clinton Y.J. Wan 213/489-3000 General Manager International Commercial Bank of China 445 S. Figueroa Street, Suite 3200 Los Angeles, CA 90071 Opened 7-2-84	#86	(LFB) CA Taipei, Taiwan
Mr. Flario Frascaroli 213/489-3100 Vice President & General Manager Istituto Bancario San Paolo di Torino 444 South Flower Street, Suite 1350 Los Angeles, CA 90071 Opened 11-26-82	#53	CA Turin, Italy

Mr. Roberto L. Paladini 212/972-7455 General Manager Banco Bandeirantes, S.A. 280 Park Avenue, 38th Floor New York, NY 10017 Opened 9-1-82	#46	NY Sao Paulo, Brazil
Mr. Jose Faria 212/688-9855 General Manager Banco Bradesco, S.A. 450 Park Avenue New York, NY 10022 Opened 6-1-82	#41	NY Sao Paulo, Brazil
Mr. Robert Warfield 212/980-1770 & 212/759-7557 General Manager Banco Consolidado, C.A. 220 East 51st Street & 10 West 58th Street New York, NY 10022 New York, NY 10019 Opened 11-4-81 & 6-28-82	#33 & #43	NY Caracas, Venezuela
Mr. L. Hernan Donoso 212/758-0909 General Manager Banco de Chile 124 East 55th Street New York, NY 10022 Opened 6-21-82	#42	NY Santiago, Chile
Mr. Manuel Roggero 212/644-6644 General Manager Banco de Credito del Peru 410 Park Avenue New York, NY 10022 Converted 12-20-83	#64	(LFB) NY Lima, Peru
Mr. Celso Barison 212/980-8383 General Manager Banco de Credito Nacional, S.A. 499 Park Avenue New York, NY 10022 Opened 1-2-81	#13	NY Sao Paulo, Brazil
Mr. Paul Carcavallo 212/307-9600 Senior Vice President & General Manager Banco de la Republica Oriental del Uruguay 1270 Avenue of the Americas, 30th Floor New York, NY 10020 Opened 10-1-81	#29	NY Montevideo, Uruguay

Mr. Aaron Kwong-Fat Cheung 213/622-0002 General Manager Ka Wah Bank Ltd. 800 Whilshire Blvd., Suite 1680 Los Angeles, CA 90017 Opened 3-17-82	#39	(LFB) NY Hong Kong, B.C.C.
Mr. Edward L. Wu 415/398-8866 General Manager Nanyang Commercial Bank Ltd. 500 Washington Street San Francisco, CA 94111 Opened 1-21-83	#57	(LFB) CA Hong Kong, B.C.C.
Mr. Phaithoon Kijsamrej 213/614-1805 Vice President & Manager Siam Commercial Bank Ltd. 444 South Flower Street Los Angeles, CA 90071 Opened 7-7-82	#44	CA Bangkok, Thailand
Mr. Beat Stueber First Vice President & Manager Union Bank of Switzerland 444 South Flower Street, Suite 4600 Los Angeles, CA 90071 Opened 1-2-87	#93	CA Zurich, Switzerland (Trust Powers)
Mr. Samuel Mills 213/627-9747 General Manager Westpac Banking Corporation 300 South Grand Avenue Los Angeles, CA 90071 Opened 5-2-84	#84	(LFB) NY Sydney, Australia
Mr. Ronald J. Lenart 415/986-4222 Vice President & Comptroller Westpac Banking Corporation 101 California Street, 38th Floor San Francisco, CA 94111 Opened 5-2-84	#83	(LFB) NY Sydney, Australia
Mr. Damon T. Kong 213/489-4193 General Manager Wing Lung Bank Ltd. 445 Figueroa Street, Suite 2710 Los Angeles, CA 90071 Opened 7-31-84	#87	(LFB) CA Hong Kong, B.C.C.

HENRY B. GONZALEZ, TEXAS
FRANK J. MURDO, ILLINOIS
WALTER E. FAUNTROY, DISTRICT OF COLUMBIA
STEWART L. NEAL, NORTH CAROLINA
CARROLL HUBBARD, KENTUCKY
JOHN J. WATKINS, NEW YORK
MARY ROSE SAKAR, OHIO
BRUCE F. VENT, MINNESOTA
DOUG BARNARD, GEORGIA
ROBERT JARCA, NEW YORK
CHARLES E. SCHUMER, NEW YORK
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THOMAS R. CARPER, DELAWARE
ESTEBAN EDWARDS, CALIFORNIA
GERALD D. KLECKA, WISCONSIN
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PETER HODGSON, NEBRASKA
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U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS

2129 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515

October 6, 1990

CHALMERS R. MYLES, OHIO
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BILL MCCOLLUM, FLORIDA
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BOB ROTH, WISCONSIN
AL MCCANDLESS, CALIFORNIA
JAMES BAUTCH, NEW JERSEY
PATRICIA SAKI, HAWAII
JIM BURNING, KENTUCKY
RICHARD H. BAKER, LOUISIANA
CLIFF STEARNS, FLORIDA
PAUL DILLON, OHIO
BILL FAXON, NEW YORK

202/225-4247

Mr. Robert L. Clarke
Comptroller of the Currency
Office of the Comptroller
of the Currency
Washington, D.C. 20219

Dear Mr. Clarke:

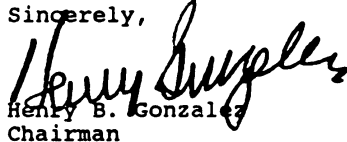
I am writing to ask you to provide additional information related to your appearance before the Banking Committee on October 16, 1990.

1. Please explain the criteria used by the OCC in determining whether or not an applicant is granted a licence for a federal branch or agency.
2. What are the primary differences between federally-licensed branches and agencies and state-licensed branches and agencies?
3. Please explain the main components of an OCC examination of a federally-licensed branch and agency.
4. In your response to previous questions regarding federally-licensed branches and agencies, you mention the concept of "managed profitability" whereby these entities are actually set up to break-even or even lose money. Please explain this concept in more detail. Are these entities being established as tax avoidance vehicles?
5. Does OCC collect information on the number of persons employed by national banks? If so, please explain why this information is not collected for federally-licensed branches and agencies.
6. Has the OCC ever revoked the licence of a branch or agency? Please explain.
7. Please provide a list of the federally-licensed branches and agencies that are owned, in whole, or in part, by foreign governments. What are the total assets of these entities.

Thank you for your time and consideration of this request. Your cooperation is most appreciated. Again, I look forward to your testimony on October 16, 1990.

With best wishes.

Sincerely,

A handwritten signature in dark ink, appearing to read "Henry B. Gonzalez", written over the typed name.

Henry B. Gonzalez
Chairman

HBG:dk



**Comptroller of the Currency
Administrator of National Banks**

Washington, D.C. 20219

October 15, 1990

The Honorable Henry B. Gonzalez
Chairman
Committee on Banking, Finance and Urban Affairs
United States House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

I am replying to your letter of October 6, 1990 to Comptroller of the Currency Robert L. Clarke requesting information concerning U. S. branches and agencies of foreign banks. In order to assure a complete response, our reply addresses each of your questions in turn.

1. Please explain the criteria used by the OCC in determining whether or not an applicant is granted a license for a federal branch or agency.

The OCC, in acting on Federal branch applications, considers the financial and managerial ability of the applicant foreign bank and the proposed Federal branch, competition, the convenience and needs of the community to be served, economic conditions and the system of supervision in the home country, and international banking expertise. If, after considering these factors, the OCC is not convinced the applicant foreign bank has a reasonable likelihood of success, the application is denied.

2. What are the primary differences between federally-licensed branches and agencies and state-licensed branches and agencies?

The primary difference between federally licensed branches and agencies and state licensed branches and agencies is one of regulatory authority. The OCC is the primary regulator for Federal branches and agencies and we discharge our responsibilities under the International Banking Act (IBA) in accordance with national treatment.

State licensed branches and agencies are primarily supervised by the state banking authority which granted them license to operate. The Federal Reserve Board shares supervisory responsibilities for state branch licensees with the state banking authorities in a number of states.

Aside from the difference in regulator, the major aspects of conducting business are the same. All licensees are subject to the same interstate banking prohibitions, reserve and deposit insurance requirements and have similar banking powers. Beyond the basics, however, there are differences with regard to pledged asset accounts, licensing procedures and fees and examinations.

Another difference is that federally licensed branches may either be a "full service" Federal branch or a limited Federal branch. Limited Federal branches are restricted to receiving international related deposits. By establishing a limited Federal branch, the foreign bank can engage in deposit taking activity in more than one state. State licensed branches can only accept deposits in one state.

3. Please explain the main components of an OCC examination of a federally-licensed branch and agency.

Generally, Federal branches and agencies can exercise the same rights and privileges available to national banks, are exposed to the same risks and are subject to the same laws, rulings, and regulations. Therefore these institutions are examined in much the same way as a national bank. Full scope examinations are conducted, which include reviews of asset quality, assessment of allowance for loan loss of both a general and a specific nature, as well as other solvency issues consistent with our responsibility under the IBA. Our examination efforts also include a review for compliance with applicable banking and consumer legislation.

4. In your response to previous questions regarding federally-licensed branches and agencies, you mention the concept of "managed profitability" whereby these entities are actually set up to break-even or even lose money. Please explain this concept in more detail. Are these entities being established as tax avoidance vehicles?

It is not believed that these entities are being established as tax avoidance vehicles. Federal branches are generally established to generate business with companies either domiciled in their home country or doing business with their home country. In some cases, a branch is not established to generate profits, but rather to refer business to the head office. Federal branches and agencies often do not generate sufficient U. S. dollar based income to offset their operating expenses. Therefore, in our experience, few federal branches and agencies generate significant taxable income.

-3-

5. Does the OCC collect information on the number of persons employed by national banks? If so, please explain why this information is not collected for federally-licensed branches and agencies.

No, the OCC does not collect information on the number of persons employed by either national banks or federally licensed branches and agencies.

6. Has the OCC ever revoked the license of a branch or agency? Please explain.

The OCC has not revoked the license of a branch or agency, but our ability to revoke or retrieve a Federal branch license remains the ultimate sanction. We believe that the IBA empowered the OCC to issue rules, regulations, and orders deemed necessary by the OCC. The same enforcement tools available to the OCC for national banks exist for Federal branches. Civil money penalties, cease and desist orders and other enforcement tools are available, and we have issued seven (7) enforcement actions during the last year.

7. Please provide a list of the federally-licensed branches and agencies that are owned, in whole, or in part, by foreign governments. What are the total assets of these entities?

There are thirteen (13) federal branches that are owned in whole, or in part by foreign governments, with total assets of \$3 billion. A listing of these is attached.

I appreciate the opportunity to share the foregoing information with you. Should you or any member of your staff require additional information or need clarification of any of the points discussed, please do not hesitate to contact this office.

Sincerely,



Stephen R. Steinbrink
Deputy Comptroller
Multinational Banking

Enclosure

<u>FEDERAL BRANCHES AND AGENCIES</u>	<u>AS OF DATE</u>	<u>TOTAL ASSETS</u> (000's)
Abu Dhabi International Bank, Inc. Curacao, Netherlands	6/30/89	126,268
Banco de la Republica Oriental del Uruguay Montevideo, Uruguay	9/30/89	323,506
Banco do Estado do Rio de Janeiro S.A. Rio de Janeiro, Brazil	7/11/90	32,718*
Banco do Estado do Rio Grande do Sul S.A. Porto Allegre, Brazil	3/31/90	4,586
Bank of China/LA Republic of China	6/30/89	21,555**
Bank of China/NY Republic of China	6/29/90	1,107,756**
Caisse Nationale de Credit Agricole Paris, France	9/30/88	214,603
Gulf International Bank BSC Manama, Bahrain	6/30/89	275,196
Middle East Bank Ltd. Dubai, United Arab	12/31/89	22,259
National Bank of Pakistan Karachi, Pakistan	8/31/89	341,519
National Commercial Bank Jeddah, Saudi Arabia	12/31/89	329,054
United Bank of Kuwait LTD London, England	8/31/89	285,552

* All numbers were retrieved from the latest bank Report of Supervisory Activity, except Banco do Estado do Rio de Janeiro, S.A. (from Quarterly Report).

** Bank of China had two bank reports: one for #96 and one for #28.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

August 10, 1990

ALAN GREENSPAN
CHAIRMAN

The Honorable Henry B. Gonzalez
Chairman
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D.C. 20515

RECEIVED

AUG - 4 1990

Finance & Urban Affairs Committee

Dear Mr. Chairman:

I am enclosing for your consideration proposed amendments to the criminal code that would cover branches and agencies of foreign banks and Edge and Agreement Corporations under provisions of the criminal code that deal with bank crimes.

As a result of an ongoing federal investigation involving a branch of a foreign bank it was recognized that many provisions of the criminal code that apply to U.S. banks do not apply to the above-mentioned banking entities even though they engage in international banking business in the United States under authority of the International Banking Act of 1978 or the Federal Reserve Act. The proposed amendments would correct this omission and include these banking offices under provisions of the criminal code dealing with bank fraud, theft, embezzlement, misapplication of funds and bribery.

The Board has reviewed these amendments and believes they should be forwarded to the Congress for appropriate consideration. We can think of no reason why these banking entities and their employees should not be covered by the criminal code in the same manner, and to the same extent, as other U.S. banking offices.

If the Board or its staff may be of further assistance, please do not hesitate to contact us.

Sincerely,

Enclosure

FINAL

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[Amdt. #1]
[9-6-90]

AMENDMENT TO H.R. 5269, AS REPORTED

OFFERED BY MR. GONZALEZ OF TEXAS

(Page and line references are to H.R. 5269, as reported by the
Judiciary Committee: Part I of Report No. 101-681)

Page 165, before line 12, insert the following new
section:

1 SEC. 2111. AMENDMENTS TO INCLUDE VARIOUS ENTITIES WHICH
2 ENGAGE IN INTERNATIONAL BANKING BUSINESS WITHIN
3 THE UNITED STATES WITHIN THE SCOPE OF FINANCIAL
4 CRIME PROVISIONS.

5 (a) DEFINITION OF FINANCIAL INSTITUTION.--Section 20 of
6 title 18, United States Code, is amended--

7 (1) by striking the period at the end of paragraph

8 (6) and inserting a semicolon; and

9 (2) by adding at the end the following new

10 paragraphs:

11 `` (7) a Federal Reserve bank or a member bank of the
12 Federal Reserve System;

13 `` (8) an organization operating under section 25 or
14 section 25(a) of the Federal Reserve Act; or

15 `` (9) a branch or agency of a foreign bank (as such

GONZAL414

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1 terms are defined in paragraphs (1) and (3) of section
2 1(b) of the International Banking Act of 1978).''.

3 (b) OFFER OF LOAN OR GRATUITY TO BANK EXAMINER.--Section
4 212 of title 18, United States Code, is amended--

5 (1) in the 1st undesignated paragraph--

6 (A) by striking ``System or the deposits of
7 which'' and inserting ``System, the deposits of
8 which'';

9 (B) by inserting ``which is a branch or agency of
10 a foreign bank (as such terms are defined in
11 paragraphs (1) and (3) of section 1(b) of the
12 International Banking Act of 1978), or which is an
13 organization operating under section 25 or section
14 25(a) of the Federal Reserve Act,'' after ``deposits
15 of which are insured by the Federal Deposit Insurance
16 Corporation,``; and

17 (C) by inserting ``branch, agency,
18 organization,`` after ``who examines or has authority
19 to examine such bank,``; and

20 (2) in the 2d undesignated paragraph--

21 (A) by striking ``System or insured'' and
22 inserting ``System, insured''; and

23 (B) by inserting ``branches or agencies of
24 foreign banks (as such terms are defined in
25 paragraphs (1) and (3) of section 1(b) of the

GONZAL414

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1 International Banking Act of 1978), organizations
 2 operating under section 25 or section 25(a) of the
 3 Federal Reserve Act," after "financial
 4 institutions,".

5 (c) ACCEPTANCE OF LOAN OR GRATUITY BY BANK

6 EXAMINER.--Section 213 of title 18, United States Code, is
 7 amended--

8 (1) by striking "System or financial institutions
 9 the deposits of which" and inserting "System, financial
 10 institutions the deposits of which";

11 (2) by inserting "which are branches or agencies of
 12 foreign banks (as such terms are defined in paragraphs
 13 (1) and (3) of section 1(b) of the International Banking
 14 Act of 1978), or which are organizations operating under
 15 section 25 or section 25(a) of the Federal Reserve Act,"
 16 after "deposits of which are insured by the Federal
 17 Deposit Insurance Corporation,";

18 (3) by inserting "branch, agency," after "accepts
 19 a loan or gratuity from any bank,".

20 (d) CUSTODIANS, GENERALLY, MISUSING PUBLIC

21 FUNDS.--Section 648 of title 18, United States Code, is
 22 amended by inserting "", including any branch or agency of a
 23 foreign bank (as such terms are defined in paragraphs (1) and
 24 (3) of section 1(b) of the International Banking Act of
 25 1978)," after "or deposits in any bank".

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1 (e) THEFT BY EXAMINER.--Section 655 of title 18, United
2 States Code, is amended--

3 (1) in the 1st undesignated paragraph--

4 (A) by striking ``System or which is insured``
5 and inserting ``System, which is insured``;

6 (B) by inserting ``which is a branch or agency of
7 a foreign bank (as such terms are defined in
8 paragraphs (1) and (3) of section 1(b) of the
9 International Banking Act of 1978), or which is an
10 organization operating under section 25 or section
11 25(a) of the Federal Reserve Act,`` after ``by the
12 Federal Deposit Insurance Corporation,``; and

13 (C) by inserting ``branch, agency, or
14 organization,`` after ``premises of such bank,``; and
15 (2) in the 2d undesignated paragraph--

16 (A) by striking ``System or banks the deposits of
17 which`` and inserting ``System, banks the deposits of
18 which``; and

19 (B) by inserting ``branches or agencies of
20 foreign banks (as such terms are defined in
21 paragraphs (1) and (3) of section 1(b) of the
22 International Banking Act of 1978), or organizations
23 operating under section 25 or section 25(a) of the
24 Federal Reserve Act,`` after ``are insured by the
25 Federal Deposit Insurance Corporation,``.

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1 (f) THEFT, EMBEZZLEMENT, OR MISAPPLICATION BY BANK
2 OFFICER OR EMPLOYEE.--Section 656 of title 18, United States
3 Code (as amended by section 2104(b) of this subtitle) is
4 amended--

5 (1) in the 1st undesignated paragraph--

6 (A) by striking ``national bank, or insured
7 bank'' and inserting ``national bank, insured bank,
8 branch or agency of a foreign bank, or organization
9 operating under section 25 or section 25(a) of the
10 Federal Reserve Act,``;

11 (B) by inserting ``insured bank, branch, agency,
12 or organization'' after ``receiver of a national
13 bank,``;

14 (C) by inserting `` , branch, agency, or
15 organization'' after ``misapplies any of the moneys,
16 funds or credits of such bank``;

17 (D) by inserting ``branch, agency, or
18 organization,`` after ``custody or care of such
19 bank,``; and

20 (2) in the 2d undesignated paragraph--

21 (A) by striking ``and'' after ``one of the
22 Federal Reserve banks,``; and

23 (B) by inserting before the period the following:
24 ``; and the term `branch or agency of a foreign bank'
25 means a branch or agency described in section 20(9)

GONZAL414

6

1 of this title''.

2 (g) CERTIFICATION OF CHECKS.--Section 1004 of title 18,
3 United States Code, is amended--

4 (1) by striking ``or'' after ``Federal Reserve bank''
5 and inserting a comma;

6 (2) by inserting ``insured bank (as defined in
7 section 3(h) of the Federal Deposit Insurance Act),
8 branch or agency of a foreign bank (as such terms are
9 defined in paragraphs (1) and (3) of section 1(b) of the
10 International Banking Act of 1978), or organization
11 operating under section 25 or section 25(a) of the
12 Federal Reserve Act,'' after ``member bank of the Federal
13 Reserve System,``; and

14 (3) by inserting `` , branch, agency, or
15 organization,`` after ``has been regularly deposited in
16 the bank''.

17 (h) BANK ENTRIES, REPORTS, AND TRANSACTIONS.--Section
18 1005 of title 18, United States Code (as amended by section
19 2104(d) of this subtitle) is amended--

20 (1) in the 1st undesignated paragraph--

21 (A) by striking ``national bank or insured bank''
22 and inserting ``national bank, insured bank, branch
23 or agency of a foreign bank, or organization
24 operating under section 25 or section 25(a) of the
25 Federal Reserve Act,``; and

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1 (B) by inserting `` , branch, agency, or
 2 organization'' after ``of such bank'' each place such
 3 term appears;

4 (2) in the 3d undesignated paragraph, by striking
 5 ``bank or company'' each place such term appears and
 6 inserting ``bank, company, branch, agency, or
 7 organization''; and

8 (3) in the last undesignated paragraph--

9 (A) by striking ``and'' after ``one of the
 10 Federal Reserve banks;''; and

11 (B) by inserting before the period the following:
 12 ``; and the term `branch or agency of a foreign bank'
 13 means a branch or agency described in section 20(9)
 14 of this title''.

15 (i) FALSE STATEMENTS IN LOAN, CREDIT, AND CROP INSURANCE
 16 APPLICATIONS.--Section 1014 of title 18, United States Code
 17 (as amended by section 2104(g) of this subtitle) is amended
 18 by inserting ``a branch or agency of a foreign bank (as such
 19 terms are defined in paragraphs (1) and (3) of section 1(b)
 20 of the International Banking Act of 1978), or an organization
 21 operating under section 25 or section 25(a) of the Federal
 22 Reserve Act,'' after ``or the National Credit Union
 23 Administration Board''.

24 (j) FRAUD AND RELATED ACTIVITY IN CONNECTION WITH
 25 COMPUTERS.--Section 1030(e)(4) of title 18, United States

GONZAL414

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1 Code, is amended--

2 (1) by striking ``and`` at the end of subparagraph
3 (F);

4 (2) by striking the period at the end of subparagraph
5 (G) and inserting a semicolon; and

6 (3) by adding at the end the following new
7 subparagraphs:

8 `` (H) a branch or agency of a foreign bank (as
9 such terms are defined in paragraphs (1) and (3) of
10 section 1(b) of the International Banking Act of
11 1978); and

12 `` (I) an organization operating under section 25
13 or section 25(a) of the Federal Reserve Act.``.

14 (k) DISCLOSURE OF INFORMATION FROM A BANK EXAMINATION
15 REPORT.--Section 1906 of title 18, United States Code, is
16 amended--

17 (1) by striking ``System, or bank insured`` and
18 inserting ``System, any bank insured``;

19 (2) by inserting `` , any branch or agency of a
20 foreign bank (as such terms are defined in paragraphs (1)
21 and (3) of section 1(b) of the International Banking Act
22 of 1978), or any organization operating under section 25
23 or section 25(a) of the Federal Reserve Act,`` after ``by
24 the Federal Deposit Insurance Corporation``;

25 (3) by inserting ``branch, agency, or organization,``

GONZAL414

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1 after ``proper officers of such bank,``;

2 (4) by inserting ``or a Federal branch or Federal
3 agency (as such terms are defined in paragraphs (5) and
4 (6) of section 1(b) of the International Banking Act of
5 1978)`` after ``national bank``;

6 (5) by inserting `` , an uninsured State branch or
7 State agency (as such terms are defined in paragraphs
8 (11) and (12) of section 1(b) of the International
9 Banking Act of 1978), or an organization operating under
10 section 25 or section 25(a) of the Federal Reserve Act``
11 after ``as to a State member bank``;

12 (6) by inserting `` , including any insured branch (as
13 defined in section 3(s) of the Federal Deposit Insurance
14 Act),`` after ``any other insured bank``; and

15 (7) by inserting ``or organization`` after ``board of
16 directors of such bank``.

17 (1) BANK ROBBERY AND INCIDENTAL CRIMES.--Section 2113(f)
18 of title 18, United States Code, is amended by inserting
19 ``including a branch or agency of a foreign bank (as such
20 terms are defined in paragraphs (1) and (3) of section 1(b)
21 of the International Banking Act of 1978),`` after
22 ``operating under the laws of the United States,``.

Page 215, strike line 19 and all that follows through

GONZAL414

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line 21 and insert the following:

1 Subtitle F--National Commission on Financial Institution
2 Crimes

Page 216, line 1, strike ``Reform, Recovery, and
Enforcement`` and insert ``Crimes``.

Page 216, strike line 5 and all that follows through line
19 (and redesignate subsequent paragraphs and any cross
reference to any such paragraph accordingly).

Page 219, strike line 10 and all that follows through
page 221, line 7 (and redesignate subsequent subsections and
any cross reference to any such subsection accordingly).

FRANK ANNUNCIO, ILLINOIS
 WALTER E. BAHRSTADT, DISTRICT OF COLUMBIA
 BYRON D. BELL, NORTH CAROLINA
 CAROL A. BISSONNETTE, ALABAMA
 JOHN A. BLALOCK, NEW YORK
 MARY ROSE BAKER, OHIO
 BRUCE F. BENTLEY, MINNESOTA
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 RICHARD H. BARNES, CALIFORNIA
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U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS

2129 RAYBURN HOUSE OFFICE BUILDING
 WASHINGTON, DC 20518

August 23, 1990

JOHN BARNES, OHIO
 NORMAN S. BARNES, CALIFORNIA
 STAR PARKER, VIRGINIA
 BILL MCCOLLUM, FLORIDA
 MARIE BARNES, NEW JERSEY
 BOB BARNES, NEBRASKA
 DAVID BARNES, CALIFORNIA
 JOHN BARNES, IOWA
 THOMAS J. BARNES, PENNSYLVANIA
 STEVE BARNETT, TEXAS
 TONY BARNES, WISCONSIN
 AL MCCANDLESS, CALIFORNIA
 JAMES BARNES, NEW JERSEY
 PATRICIA BARNES, HAWAII
 JIM BARNES, KENTUCKY
 RICHARD H. BARNES, LOUISIANA
 CLIFF STEVENS, FLORIDA
 PAUL BARNES, OHIO
 BILL BARNES, NEW YORK

DD2 225-4367

John P. LaWare, Member,
 Board of Governors of the
 Federal Reserve System, and
 Chairman, FRB's Committee
 on Supervision
 20th & C Streets, N.W.
 Washington, D.C. 20551

Dear Governor LaWare:

During your testimony before the House Banking Committee on August 9, 1990, I briefly mentioned that I would be writing you to get additional information on the U.S. branches and agencies of foreign banks. I would be most appreciative if you could answer the following questions regarding this issue.

- 1) Please explain the entire regulatory structure for such entities, including chartering, regulation and examination.
- 2) What is Federal Reserve's role regarding the U.S. branches and agencies of foreign banks?
- 3) Regarding the regulation and examination of these entities, please explain the coordination that occurs between the Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the state bank regulatory agencies.
- 4) Please provide financial information on the U.S. branches and agencies of foreign banks including aggregate balance sheet and income statement data, number of branches and agencies and their total employees. Please distinguish between state-chartered and federally-chartered.
- 5) How many of these entities are insured by FDIC? What percentage of the aggregate liabilities of these entities are insured by the FDIC?

- 6) How often are these entities examined by the Federal Reserve? How many examiners does the Federal Reserve have specifically dedicated to examining these entities? Please differentiate between state-chartered versus federally-chartered branches and agencies.
- 7) Please explain the enforcement authority of the Federal Reserve as it pertains to the U.S. branches and agencies of foreign banks.
- 8) This question concerns Banca Nazionale del Lavoro (BNL).
 - A. How often did the Federal Reserve examine the U.S. operations of BNL over the past five years?
 - B. On what date was the Federal Reserve notified of the BNL scandal?
 - C. What was the Federal Reserve's role in the BNL investigation?
- 9) Do the U.S. branches and agencies of foreign banks have access to the discount window? Please explain.
- 10) Are all U.S. branches and agencies of foreign banks not subject to criminal penalties such as bank fraud, embezzlement, false bank entries, misapplication of funds, and bribery as enumerated under Title 18 of the U.S. Code? Please explain.
- 11) Please explain the amendments your General Counsel drafted to ensure the U.S. branches and agencies of foreign banks are subject to the criminal penalties such as bank fraud, embezzlement, false bank entries, misapplication of funds, and bribery as enumerated under Title 18 of the U.S. Code?

Thank you for your time and consideration of this request. If you have any questions regarding this request, please feel free to contact Mr. Dennis Kane of my staff at (202) 225-4247.

Your cooperation is most appreciated, and I look forward to your timely reply.

With best wishes.

Sincerely,

Henry B. Gonzalez
Henry B. Gonzalez
Chairman

HBG:dk

HENRY B. GONZALEZ, TEXAS, CHAIRMAN
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U.S. HOUSE OF REPRESENTATIVES
 COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS
 2129 RAYBURN HOUSE OFFICE BUILDING
 WASHINGTON, DC 20515

October 6, 1990

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 BILL PAXON, NEW YORK

202-225-4247

John P. LaWare, Member,
 Board of Governors of the
 Federal Reserve System, and
 Chairman, FRB's Committee
 on Supervision
 20th & C Streets, N.W.
 Washington, D.C. 20551

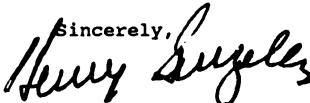
Dear Governor LaWare:

I am writing to ask you to provide the following additional information related to your appearance before the Banking Committee on October 16, 1990.

1. Please provide a list of the state-licensed branches and agencies that are owned, in whole, or in part, by foreign governments. What are the total assets of these entities? What percent of their liabilities are insured by FDIC?
2. A foreign bank can be owned, in whole or in part, by a foreign government or by private interests in a foreign country. Related to the regulation and supervision of branches and agencies of foreign banks, does the Federal Reserve differentiate in any way between those branches and agencies that are run by foreign banks that are owned by foreign governments versus those that are run by foreign banks that are privately owned?

Thank you for your time and consideration of this request. Your cooperation is most appreciated. Again, I look forward to your testimony on October 16, 1990.

With best wishes.

Sincerely,

 Henry B. Gonzalez
 Chairman

Number of Foreign
Banks with State
Licensed Branches
or Agencies

State

Primary Examining Authority

California	112	Fed / State alternate year basis
Florida	39	State - (Fed has increased participation in examinations and increased independent exams)
Georgia	24	Fed / State alternate year basis
Hawaii	2	Fed / State jointly
Illinois	53	State - (Fed has reduced its participation in examinations as the state examiners have become more experienced, but participates in selected exams)
Massachusetts	8	State
New York	247	State (with limited Fed participation in large branches & agencies)
Oregon	4	Fed / State jointly
Pennsylvania	4	State
Texas	21	Fed / State jointly
Washington	8	State

U.S. OFFICES OF FOREIGN BANKS Federally licensed branches
and agencies, controlled by Foreign Governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=AUSTRIA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
COMMONWEALTH BANK AUSTRALIA	CHICAGO	\$4	Branch	no	
COMMONWEALTH BANK AUSTRALIA	NEW YORK	\$239	Branch	no	
STATE BANK OF NEW S WALES	NEW YORK	\$435	Branch	no	
COUNTRY		\$678			
N=	3				
COUNTRY=AUSTRIA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
CREDITANSTALT-BANKVEREIN	ATLANTA	\$0	Agency	no	
CREDITANSTALT-BANKVEREIN	NEW YORK	\$488	Branch	no	
OSTERREICHISCHE LN BK	NEW YORK	\$762	Branch	no	
COUNTRY		\$1,250			
N=	3				
COUNTRY=BAHRAIN					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
GULF INTL BANK BSC	NEW YORK	\$351	Branch	no	
N=	1				
COUNTRY=BRAZIL					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BCO DO EST DO RIO DE JNRO	NEW YORK	\$27	Branch	no	
BNCO DO EST DO PARANA SA	NEW YORK	\$28	Branch	no	
BCO ESTADO RIO GRANDE SUL	NEW YORK	\$3	Branch	no	
COUNTRY		\$58			
N=	3				

U.S. OFFICES OF FOREIGN BANKS Federally licensed branches
and agencies; controlled by foreign governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=CHINA (MAINLAND)					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANK OF CHINA	NEW YORK	\$1,108	Branch	yes	
N= 1					
COUNTRY=FRANCE					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
UNITED BANK FOR AFRICA LTD	NEW YORK	\$153	Branch	no	
CAISSE NAT DE CREDIT AGRIC	NEW YORK	\$242	Branch	no	
COUNTRY		\$395			
N= 2					
COUNTRY=GERMANY (WEST)					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BAY LANDESSBK GIRONTRLE	NEW YORK	\$1,584	Branch	no	
N= 1					
COUNTRY=INDONESIA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANK RAKYAT INDONESIA	NEW YORK	\$247	Agency	no	
N= 1					
COUNTRY=ITALY					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO DI ROMA INSTN AGENCY	HOUSTON	\$91	Agency	no	
FIRST BANC SN PAOLO TORINO	LOS ANGELES	\$894	Branch	no	
INST BANC SAN PAOLO TORINO	NEW YORK	\$4,062	Branch	no	
COUNTRY		\$5,047			
N= 3					

U.S. OFFICES OF FOREIGN BANKS Federally licensed branches
and agencies, controlled by foreign governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY-NEW ZEALAND				
Office	Location	Total Assets	Entity type	Federal deposit insurance
BANK OF NEW ZEALAND	NEW YORK	\$806	Branch	no
N= 1				
COUNTRY-PAKISTAN				
Office	Location	Total Assets	Entity type	Federal deposit insurance
NATIONAL BANK OF PAKISTAN	WASHINGTON	\$365	Branch	no
N= 1				
COUNTRY-PORTUGAL				
Office	Location	Total Assets	Entity type	Federal deposit insurance
BANCO FONSECAS & BURNAY	NEW YORK	\$175	Agency	no
N= 1				
COUNTRY-SAUDI ARABIA				
Office	Location	Total Assets	Entity type	Federal deposit insurance
SAUDI INTERNATIONAL BANK	NEW YORK	\$7	Branch	no
N= 1				
COUNTRY-THAILAND				
Office	Location	Total Assets	Entity type	Federal deposit insurance
KRUNG THAI BANK LIMITED	NEW YORK	\$107	Branch	no
SIAM COMMERCIAL BANK LIMITED	LOS ANGELES	\$54	Branch	no
COUNTRY		\$161		
N= 2		4		

U.S. OFFICES OF FOREIGN BANKS Federally licensed branches
and agencies, controlled by Foreign Governments.
As of June 30, 1990. Dollar amounts in millions.

----- COUNTRY=U.A.E. -----					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
ABU DHABI INTL BK INC	WASHINGTON	9127	Branch	no	
N= 1					
----- COUNTRY=URUGUAY -----					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO REP ORINT URUGUAY	NEW YORK	8356 ***** \$12,715	Branch	no	
N= 1					

U.S. OFFICES OF FOREIGN BANKS State licensed branches
and agencies, controlled by Foreign Governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=ARGENTINA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO DE LA NACION ARG. AGENCY	MIAMI	\$126	Agency	no	
BANCO DE LA NACION ARGENTINA	NEW YORK	\$153	Branch	no	
BANCO DE LA PRINC DE BNS ARS	NEW YORK	\$505	Agency	no	
COUNTRY		-----			
		\$782			
N=	3				
COUNTRY=AUSTRALIA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
COMMONWEALTH BANK AUSTRALIA	LOS ANGELES	\$29	Agency	no	
STATE BK OF VICTORIA	NEW YORK	\$121	Agency	no	
COUNTRY		-----			
		\$150			
N=	2				
COUNTRY=BRAZIL					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO DO BRAZIL SA	MIAMI	\$159	Agency	no	
BANCO DO BRAZIL SA	NEW YORK	\$713	Branch	no	
BANCO DO BRAZIL SA AGENCY	LOS ANGELES	\$310	Agency	no	
BANCO DO BRAZIL SA AGENCY	SAN FRANCISCO	\$150	Agency	no	
BANCO DO ESTADO DE SAO PAULO	SAN FRANCISCO	\$92	Agency	no	
BANCO DO ESTADO DE SAO PAULO	MIAMI	\$615	Agency	no	
BANCO DO ESTADO DE SAO PAULO	NEW YORK	\$577	Branch	no	
COUNTRY		-----			
		\$2,561			
N=	7				
COUNTRY=CHINA (MAINLAND)					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANK OF CHINA	LOS ANGELES	\$62	Branch	no	
N=	1				

U.S. OFFICES OF FOREIGN BANKS State licensed branches
and agencies, controlled by Foreign Governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=EL SALVADOR					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO AGCL CMCR DE EL SILVO	SAN FRANCISCO	90	Agency	no	
BANCO AGRICOLA CMR DE EL SAL	LOS ANGELES	91	Agency	no	
COUNTRY		91			
N=	2				
COUNTRY=FRANCE					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANQUE NATIONALE DE PARIS	CHICAGO	\$368	Branch	no	
BANQUE NATIONALE DE PARIS	NEW YORK	\$5,856	Branch	no	
BANQUE NATIONALE DE PARIS AG	LOS ANGELES	939	Agency	no	
BANQUE NATIONALE DE PARIS AG	SAN FRANCISCO	\$1,115	Agency	no	
BANQUE NATIONALE DE PARIS AG	CHICAGO	976	Agency	no	
CAISSE NAT DE CRED AGRICOLE	CHICAGO	976	Agency	no	
CAISSE NATIONALE DE CRED AGR	LOS ANGELES	45	Branch	no	
CREDIT LYONNAIS	LOS ANGELES	958	Branch	no	
CREDIT LYONNAIS	CHICAGO	862	Branch	no	
CREDIT LYONNAIS	NEW YORK	\$7,109	Branch	no	
CREDIT LYONNAIS AGENCY	SAN FRANCISCO	84	Agency	no	
CREDIT LYONNAIS AGENCY	MIAMI	886	Agency	no	
COUNTRY		\$13,555			
N=	12				

COUNTRY=GERMANY (WEST)					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
HERSTICHE LANDESBANK OPTLE	NEW YORK	\$567	Branch	no	
HERSTDEUTSCHE LANDESBANK	NEW YORK	\$2,046	Branch	no	
COUNTRY		\$2,613			
N=	2				

U.S. OFFICES OF FOREIGN BANKS State licensed branches
and agencies, controlled by foreign governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=GREECE					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
NATIONAL BANK OF GREECE SA	CHICAGO	\$65	Branch	yes	
NATIONAL BANK OF GREECE SA	BOSTON	\$87	Branch	yes	
COUNTRY		\$150			
N=	2				
COUNTRY=INDIA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANK OF BARODA	NEW YORK	\$106	Branch	yes	
BANK OF INDIA	NEW YORK	\$156	Branch	yes	
BANK OF INDIA AGENCY	SAN FRANCISCO	\$15	Agency	no	
STATE BANK OF INDIA	CHICAGO	\$19	Branch	yes	
STATE BANK OF INDIA	NEW YORK	\$311	Branch	yes	
STATE BANK OF INDIA AGENCY	LOS ANGELES	\$100	Agency	no	
STATE BK OF INDIA (BIDNY)	NEW YORK	\$22	Branch	no	
COUNTRY		\$809			
N=	7				
COUNTRY=INDONESIA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANK BUMI DAYA	NEW YORK	\$242	Branch	no	
BANK DAGANG NEGARA	LOS ANGELES	\$283	Agency	no	
BANK NEGARA NEGARA	NEW YORK	\$167	Agency	no	
BANK NEGARA INDONESIA 1946	NEW YORK	\$626	Branch	no	
BANK EKSPOR IMPOR IND	NEW YORK	\$455	Branch	no	
COUNTRY		\$1,771			
N=	5				

U.S. OFFICES OF FOREIGN BANKS. State licensed branches
and agencies, controlled by Foreign Governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=IRAN					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANK MELLI IRAN AGENCY	LOS ANGELES	85	Agency	no	
BANK MELLI IRAN AGENCY	NEW YORK	89	Agency	no	
BANK SEPAH IRAN AGENCY	NEW YORK	80	Agency	no	
COUNTRY		---			
		612			
N=	3				

COUNTRY=ITALY					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCA COMMERCIALE ITALIANA	CHICAGO	8206	Branch	no	
BANCA COMMERCIALE ITALIANA	NEW YORK	85,853	Branch	no	
BANCA COMM. ITALIANA AGENCY	LOS ANGELES	8129	Agency	no	
BANCA NAZIONALE DEL LAVORO	MIAMI	8264	Agency	no	
BANCA NAZIONALE DEL LAVORO	ATLANTA	82,342	Agency	no	
BANCA NAZIONALE DEL LAVORO	LOS ANGELES	8190	Agency	no	
BANCA NAZIONALE DEL LAVORO	CHICAGO	8171	Branch	no	
BANCA NAZIONALE DEL LAVORO	NEW YORK	95,613	Branch	no	
BANCA NAZIONALE DEL LAVORO	NEW YORK	85,535	Branch	no	
BANCA NAZIONALE DEL LAVORO	NEW YORK	81,910	Branch	no	
BANCA NAZIONALE DEL LAVORO	CHICAGO	84,508	Branch	no	
BANCA DI ROMA	NEW YORK	81,542	Agency	no	
BANCA DI ROMA AGENCY	SAN FRANCISCO	8784	Branch	no	
BANCA DI SICILIA	NEW YORK	8171	Agency	no	
BANCA DI SICILIA AGENCY	LOS ANGELES	8986	Branch	no	
BANCA DI SANTO SPIRITO SPA	NEW YORK	82,152	Branch	no	
CREDITO ITALIANO	NEW YORK	8115	Agency	no	
CREDITO ITALIANO AGENCY	LOS ANGELES	81,685	Branch	no	
MONTI DEI PASCHI DI SIENA	NEW YORK	---			
COUNTRY		835,416			
N=	18				

COUNTRY=JAPAN					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
SHOKO CHUKIN BK	NEW YORK	81,175	Branch	no	
N=	1				

U.S. OFFICES OF FOREIGN BANKS State licensed branches
and agencies, controlled by Foreign Governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=KOREA, SOUTH				
Office	Location	Total Assets	Entity type	Federal deposit insurance
KOREA EXCHANGE BANK	CHICAGO	\$143	Branch	yes
KOREA EXCHANGE BANK	FLUSHING	\$58	Branch	no
KOREA EXCHANGE BANK	NEW YORK	\$1,011	Branch	yes
KOREA EXCHANGE BANK	NEW YORK	\$71	Branch	yes
KOREA EXCHANGE BANK	SEATTLE	\$282	Branch	no
KOREA EXCHANGE BANK AGENCY	LOS ANGELES	\$529	Agency	no
COUNTRY		-----		
		\$2,074		
N=	6			

COUNTRY=MALAYSIA				
Office	Location	Total Assets	Entity type	Federal deposit insurance
BK BUMIPUTRA MALAYSIA BER	NEW YORK	\$286	Branch	no
BK BUMIPUTRA MALAYSIA BERHAD	LOS ANGELES	\$17	Agency	no
MALAYAN BANKING BERHAD	NEW YORK	\$295	Branch	no
COUNTRY		-----		
		\$720		
N=	3			

COUNTRY=MEXICO				
Office	Location	Total Assets	Entity type	Federal deposit insurance
BANCO NACIONAL DE MEX HN ADY	HOUSTON	\$110	Agency	no
BANCO NACIONAL DE MEXICO	NEW YORK	\$875	Agency	no
BANCO NACIONAL DE MEXICO AG	LOS ANGELES	\$40	Agency	no
BANCA SERFIN SNC	NEW YORK	\$358	Agency	no
BANCA SERFIN SNC AGENCY	LOS ANGELES	\$238	Agency	no
BANCO INTERCONTINENTAL SNC	NEW YORK	\$304	Agency	no
BANCO MEXICANO SA	NEW YORK	\$41	Agency	no
BANCOMER SNC	NEW YORK	\$810	Agency	no
BANCOMER SNC AGENCY	LOS ANGELES	\$920	Agency	no
MULTIBANCO COMEREX SNC	NEW YORK	\$328	Agency	no
COUNTRY		-----		
		\$3,775		
N=	10			

U.S. OFFICES OF FOREIGN BANKS State licensed branches
and agencies, controlled by Foreign Governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=PAKISTAN					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
HABIB BANK	NEW YORK	\$231	Branch	no	
NATIONAL BANK OF PAKISTAN	CHICAGO	\$2	Branch	yes	
NATIONAL BANK OF PAKISTAN	NEW YORK	\$187	Branch	no	
UNITED BANK LIMITED	NEW YORK	\$49	Branch	no	
COUNTRY		\$469			
N=	4				
COUNTRY=PANAMA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO NACIONAL DE PANAMA	NEW YORK	\$0	Branch	no	
N=	1				
COUNTRY=PHILIPPINES					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
PHILIPPINE NATIONAL BANK	LOS ANGELES	\$17	Branch	no	
PHILIPPINE NATIONAL BANK	NEW YORK	\$32	Branch	no	
PHILIPPINE NATIONAL BANK AGC	HONOLULU	\$1	Agency	no	
COUNTRY		\$50			
N=	3				
COUNTRY=PORTUGAL					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO TOTTA & AORRES	NEW YORK	\$323	Agency	no	
BANCO PORTUGUES DO ATLANTICO	NEW YORK	\$248	Branch	no	
BDO PORT DO ATLANTICO EP	MIAMI	\$70	Agency	no	
COUNTRY		\$641			
N=	3				

U.S. OFFICES OF FOREIGN BANKS State licensed branches
and agencies, controlled by Foreign Governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=NEW ZEALAND					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
DVLPHENT BK OF SINGAPORE LTD	LOS ANGELES	\$27	Agency	no	
DVLPHENT BK OF SINGAPORE LTD	NEW YORK	\$303	Agency	no	
COUNTRY		\$330			
N=	2				
COUNTRY=SPAIN					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO EXTERIOR DE ESPANA SA	LOS ANGELES	\$93	Agency	no	
BANCO EXTERIOR DE ESPANA SA	MIAMI	\$246	Agency	no	
COUNTRY		\$339			
N=	2				
COUNTRY=TAIWAN					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANK OF CHINA CO	SAN JOSE	\$138	Branch	no	
CHANG HWA CHCL BK LTD	NEW YORK	\$235	Branch	no	
COUNTRY		\$373			
N=	2				
COUNTRY=THAILAND					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
SIAM COMMERCIAL BANK LIMITED	NEW YORK	\$202	Branch	no	
N=	1				
COUNTRY=TRINIDAD AND TOBAGO					
Office	Location	Total Assets	Entity type	Federal deposit insurance	

U.S. OFFICES OF FOREIGN BANKS State licensed branches
and agencies, controlled by foreign governments.
As of June 30, 1990. Dollar amounts in millions.

COUNTRY=TURKEY					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
T C ZIRAAT BANKASI	NEW YORK	\$435	Branch	no	
N= 1					
COUNTRY=VENEZUELA					
Office	Location	Total Assets	Entity type	Federal deposit insurance	
BANCO IND DE VENEZUELA CA	MIAMI	\$47	Agency	no	
BANCO IND DE VENEZUELA CA	NEW YORK	\$433	Agency	no	
COUNTRY		\$500			

		\$68,965			
N= 2					



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

October 12, 1990

JOHN P. LAWARE
MEMBER OF THE BOARD

The Honorable Henry B. Gonzalez
Chairman
Committee on Banking, Finance and
Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am responding to your letter of August 23 in which you asked a number of follow-up questions to my testimony before the House Committee on Banking, Finance and Urban Affairs on August 9, 1990.

The answers to your questions are presented in the enclosure. Please let me know if I can be of further assistance.

Sincerely,

John P. LaWare

John P. LaWare

Enclosure

1. Please explain the entire regulatory structure for such entities, including chartering, regulation and examination.

Answer

Prior to the passage of the International Banking Act of 1978 (IBA), the U.S. operations of foreign banks conducted through branches and agencies had been governed by state banking laws and supervised by state banking authorities. The IBA established a framework for federal participation in the supervision of the U.S. operations of foreign banks.

The IBA gave foreign banks the option of a federal license for their branches and agencies. Currently, in addition to the OCC, eleven states have licensed branches or agencies to operate within their state. Criteria for licensing of a foreign bank branch or agency varies among the states and between the states and the OCC.

Under the IBA, foreign bank branches that accept deposits of less than \$100,000 are required to obtain deposit insurance from the FDIC. The IBA gave the Federal Reserve broad authority to supervise and regulate foreign banks that engage in banking in the United States. Therefore, all three federal banking agencies are involved in some way with the supervision and regulation of the U.S. branches and agencies of foreign banks. On June 20, 1979, the federal bank regulatory agencies adopted a supervisory policy statement through the Federal Financial Institutions Examination Council (FFIEC). The regulatory agencies stated that their supervisory interests were directed towards ensuring that the operations of branches and agencies are conducted in a safe and sound manner and serve the needs of the borrowers, depositors and other creditors in the United States and that the branches and agencies of foreign banks adhere to U.S. laws and regulations.

The regulatory authority primarily responsible for the supervision and examination of individual branches and agencies is the licensing agency, whether state or federal (OCC), or the FDIC if retail deposits are accepted. The Federal Reserve is involved, to varying degrees, in the examinations conducted by the various states.

Shortly after passage of the IBA, the federal bank regulatory agencies, together with many of the state supervisory agencies, developed a uniform Report of Examination for Branches and Agencies of Foreign Banks (FFIEC 005). This report was approved by the FFIEC in 1979 and recommended for use by the state banking authorities. This report was substantially revised in 1984 and is currently undergoing less extensive revisions.

The federal banking regulatory agencies also developed a uniform Report of Condition (FFIEC 002) that is required to be completed on a quarterly basis by each branch and agency. This report is similar to the one prepared by all insured banks and provides information needed to monitor the condition of the U.S. branches and agencies of foreign banks. This report became effective as of June 30, 1980 and has undergone minor revisions in subsequent years.

In addition to the quarterly Report of Condition, branches and agencies must also file the Country Exposure Report for U.S. Branches and Agencies of Foreign Banks (FFIEC 019). This report is filed on a quarterly basis by branches and agencies that have total claims on foreign residents in excess of \$30 million. The report provides information on exposure to the home country and the next five countries for which exposure is the largest (and in excess of \$5 million). This report was implemented in 1987.

2. What is Federal Reserve's role regarding the U.S. branches and agencies of foreign banks?

Answer

The Federal Reserve has no licensing authority with regard to branches and agencies of foreign banks. The IBA gave the Federal Reserve authorization to act as the residual examining agency in order to ensure a national overview of multi-state activities of foreign banks. The Board, as the residual examining authority, is responsible for reviewing the operations of all branches and agencies. In keeping with the requirement of the IBA, the Board is relying, to the maximum extent possible, upon examinations that are conducted by the primary federal or state banking authority, although it is sharing examination responsibilities in several states. The Federal Reserve has, however, begun to assert its residual examination authority in certain cases, especially when individual states are having problems meeting their examination schedules, when the Federal Reserve has concerns about the adequacy of the state examinations or when extraordinary problems exist. The Board has requested that all federal and state chartered branches and agencies be examined once during every eighteen months and this schedule is, for the most part, being followed.

Each of the nine Federal Reserve Banks with foreign bank branches and agencies in their districts have developed ongoing relationships with the states licensing these institutions. With regard to examinations, various coordinated efforts exist. For example, the Federal Reserve Bank of San Francisco examines the branches and agencies of foreign banks located in California on an alternate year basis with the State of California. They examine branches and agencies in Oregon and Hawaii on a joint basis with these two States and take a very active role in these examinations. Lastly, the San Francisco Fed has a very limited presence during the examinations of foreign bank branches and agencies in the State of Washington.

Over the past ten years, the relationships between the states and the various Federal Reserve Banks have evolved as the states have gained more expertise and have increased their staffs devoted to the examinations of foreign bank branches and agencies. During 1989, 295 branches and agencies were examined of which the Federal Reserve participated, to some extent, in 169 (or 57%). The Federal Reserve is least involved with the examinations of branches and agencies in the State of New York. The New York State Banking Department had a long history of examining branches and agencies of foreign banks prior to the passage of the International Banking Act and the large expansion of foreign banks into other states during the early 1980's. The State

of New York, therefore, has not requested Federal Reserve involvement in the examination process as highlighted by the fact that the Federal Reserve Bank of New York only participated in ten of the 113 examinations of branches and agencies conducted by the State of New York during 1989.

While the U.S. banking regulatory agencies have developed a supervisory program to review the U.S. operations of foreign banks, the ultimate responsibility for those operations resides in the head office, located outside the United States. The Board felt it necessary to be able to assure itself about the consolidated condition of the foreign parent bank; therefore, the Board imposed annual reporting requirements for all foreign banks that engage in banking in the United States. These reports (FR Y-7 and FR 2068) were first implemented in 1981 and cover the financial condition of the foreign bank as well as provide information on their direct and indirect U.S. activities. It is felt that these reports assist the Board in analyzing the parent organization's ability to act as a source of strength to its U.S. branches and agencies.

In addition to the various reporting requirements and participation in examinations, the Federal Reserve has taken an active role in meeting with both branch and agency management in the United States and parent bank management in the home country.

The various Reserve Banks have developed schedules for meeting with branch and agency management on a regular (usually annual) basis in order to discuss topics of interest and concern. Board staff has called on the parent bank management of many of the largest foreign banks with significant U.S. operations in order to gain insight into the operations and financial condition of the parent organization and to learn of their business plans for their U.S. branches and agencies.

3. Regarding the regulation and examination of these entities, please explain the coordination that occurs between the Federal Reserve, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the state bank regulatory agencies.

Answer

The federal and state banking agencies coordinate the regulation and examination of branches and agencies of foreign banks through various formal and informal channels. The Federal Financial Institutions Examination Council (FFIEC) provides an avenue for formal coordination between the Federal Reserve, the OCC and the FDIC as regards development and initiation of required quarterly data reports and reports of examination. The three federal agencies also work with the Conference of State Bank Supervisors. The various Federal Reserve Banks have close working relationships with the state supervisory agencies within their respective districts and it is at the Reserve Bank level that such matters as examination coordination are handled.

On several occasions, the federal and state banking authorities have had to work closely on supervisory matters related to problem offices and the implementation of formal enforcement actions. These exceptional cases have demonstrated the ability of the various regulatory agencies to provide coordinated comprehensive and forceful supervision of problem branches and agencies.

4. Please provide financial information on the U.S. branches and agencies of foreign banks including aggregate balance sheet and income statement data, number of branches and agencies and their total employees. Please distinguish between state-chartered and federally-chartered.

U.S. BRANCHES AND AGENCIES OF FOREIGN BANKS

Aggregate Balance Sheet data as of June 30, 1990, dollar amounts in millions.

	FEDERALLY LICENSED	STATE LICENSED	TOTAL COMBINED
<i>Total assets</i>	\$33,296	\$541,642	\$574,938
<i>Total loans (net of unearned income)</i>	\$13,119	\$254,313	\$267,432
<i>Total deposits and credit balances</i>	\$14,926	\$229,859	\$244,785
<i>Total liabilities to non-related parties</i>	\$29,340	\$480,223	\$509,563

/1 Data collected from one federally licensed agency and seventy-one federally licensed branches.

/2 Data collected from 189 state licensed agencies and 270 state licensed branches.

/3 Includes fifty-five FDIC insured, federal or state licensed branches.

FDIC insured branches comprise 1.5% of aggregate total liabilities to non-related parties.

Note: Financial information collected from the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC002). Balances of International Banking Facilities (IBFs) are included. Information regarding total employees, and income derived from foreign bank's U.S. branch and agency operations is not readily available.

5. How many of these entities are insured by FDIC? What percentage of the aggregate liabilities of these entities are insured by the FDIC?

Answer

There are 55 FDIC insured Federal or State licensed branches which comprise 1.5% of the aggregate total liabilities of all branches and agencies to non-related parties.

6. How often are these entities examined by the Federal Reserve? How many examiners does the Federal Reserve have specifically dedicated to examining these entities? Please differentiate between state-chartered versus federally-chartered branches and agencies.

Answer

As previously discussed, the Federal Reserve is not the primary examining authority for any of the branches or agencies of foreign banks. Therefore, it is difficult to provide any uniform data on the involvement of the Federal Reserve in examinations as it varies significantly from state to state. It can be said that the Federal Reserve has virtually no participation in the examinations of federally-licensed or FDIC insured branches and agencies. Most branches and agencies are examined on an eighteen month cycle and the Federal Reserve reviews all of the reports derived from these examinations whether or not the Federal Reserve participated.

It is also difficult to provide information on the number of Federal Reserve examiners involved in examining branches and agencies of foreign banks. In most cases, Reserve Bank examiners not only examine branches and agencies but are also actively involved in the examination of international activities of U.S. banks and bank holding companies and Edge Corporations.

7. Please explain the enforcement authority of the Federal Reserve as it pertains to the U.S. branches and agencies of foreign banks.

The Federal Deposit Insurance Act ("FDI Act"), as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), designates the "appropriate Federal banking agency" to which enforcement authority is given for the various offices of foreign banks in the United States. The Federal Reserve is the agency designated with enforcement authority over foreign banks without an insured branch, and state-chartered agencies and commercial lending companies (12 USC 1818(q)(2)). The Office of the Comptroller of the Currency is the Federal banking agency for federal branches and agencies of foreign banks (12 USC 1818(q)(1)). The Federal Deposit Insurance Corporation is the designated agency for foreign banks with an insured branch (12 USC 1818(q)(3)). The Federal Reserve also has special enforcement authority over any branch or agency with respect to any provision of the Federal Reserve Act which is made applicable under the International Banking Act of 1978 (12 USC 1818(q)(2)(B)).

The federal bank regulatory agencies now have statutory authority with respect to U.S. branches and agencies of foreign banks to pursue the full range of enforcement remedies provided in the FDI Act. These remedies include: cease-and-desist orders; temporary cease-and-desist orders; suspension and removal authority over directors, officers, employees, agents and other persons participating in the affairs of the branch or agency; civil money penalties; and criminal penalties. (12 USC 1813(a)(1), (c)(3); 1818(b)-(j)).

The Federal Reserve Board is also given the authority to pursue these remedies against a foreign bank as if it were a bank holding company and against any of the foreign bank's nonbank subsidiaries (12 USC 1818(b)(4)). The exceptions to this authority over foreign banks are that the Federal Reserve does not have suspension and removal authority over, nor can criminal penalties be imposed on, persons affiliated only with the foreign bank and not its U.S. branches and agencies.

8. These questions concern Banca Nazionale del Lavoro (BNL).

A. How often did the Federal Reserve Examine the U.S. operations of BNL over the past five years?

Answer

Banca Nazionale del Lavoro (BNL) has branches in New York and Chicago and agencies in Miami, Atlanta, and Los Angeles. As required under the International Banking Act, the Federal Reserve accepts the on-site examinations conducted by the licensing authorities which, in the case of BNL, are the States of New York, Florida, Illinois, Georgia and California. Federal Reserve believes that branches and agencies of the foreign banks should be examined at least every 18 months. In some states, such as California, the Federal Reserve conducts alternate year examinations on a twelve month cycle. In Florida, the Federal Reserve Bank of Atlanta conducts yearly examinations of the Florida agencies. In New York, Illinois and Georgia, the State Bank Supervisory Authorities conduct the examinations. In summary, the states conducted 17 examinations of BNL from 1985 through 1990 while the Federal Reserve conducted 6 examinations directly. Each office of BNL was examined within the eighteen month guideline and most were examined yearly.

B. On what date was the Federal Reserve notified of the BNL scandal?

Answer

The Federal Reserve was notified of possible irregularities at the Atlanta Branch on July 28, 1989.

C. What was the Federal Reserve's role in the BNL investigation?

Answer

On August 4, 1989, the Federal Reserve began an examination of BNL Atlanta. The Federal Bureau of Investigation entered the bank simultaneously with Federal bank examiners to obtain and secure any and all files relating to the suspected unreported activities. The Reserve Bank provided the FBI with assistance in identifying the records associated with the unreported activities.

The Reserve Banks of Atlanta, Chicago, New York and San Francisco conducted simultaneous examinations on all other U.S. offices of BNL. These examinations were intended to focus on whether any other unreported transactions were evident in these offices and to conduct a regular examination of all activities to review asset quality and to

determine whether adequate internal controls were in place. All suspicious activities that were identified, which were confined to the Atlanta agency, were referred to appropriate agencies such as Customs, Internal Revenue Service, Department of Defense, Export-Import Bank and Commodity Credit Corporation, to determine whether these activities complied fully with all pertinent laws, rules and regulations.

The Federal Reserve Bank of Atlanta has detailed an examiner to the U.S. Attorney's Office on a full time basis to assist in analyzing documents, conducting witness interviews and preparing possible indictments. Staff of both the Federal Reserve Bank of Atlanta and the Federal Reserve Board continue to remain in close communication with the U.S. Attorney's Office in order to provide any requested support.

9. Do the U.S. branches and agencies of foreign banks have access to the discount window? Please explain.

U.S. branches and agencies of foreign banks were provided access to the Federal Reserve's credit facilities when Congress enacted the International Banking Act of 1978 (the "IBA"). One of the purposes of the IBA was to provide for competitive equality between domestic and foreign banking organizations within the United States. The legislation adopted a principle of national treatment -- or parity of treatment for domestic and foreign banking institutions in similar circumstances. In accordance with this principle, the IBA amended the Federal Reserve Act to provide access to the discount window to U.S. branches and agencies of foreign banks that maintain reserves in the United States (12 USC 347d).

All U.S. branches of foreign banks are subject to reserve requirements to the same extent as U.S. banks (12 USC 461). In addition, any U.S. agency of a foreign bank with more than one billion dollars in worldwide assets (or any foreign bank whose parent has more than one billion dollars in worldwide assets) is subject to federal reserve requirements (12 USC 3105(a)). Thus, all U.S. branches of foreign banks and all U.S. agencies of foreign banking organizations with more than one billion in worldwide assets are subject to federal reserve requirements and therefore have access to the discount window.

Under the Federal Reserve Act, as amended by the IBA, Reserve Banks are authorized to discount paper endorsed by, and make advances to, U.S. branches and eligible agencies of foreign banks in the same manner and to the same extent that they may exercise such powers with respect to member banks. The Reserve Banks are, however, mandated to consider the account balances that the branch or agency maintains with the Reserve Bank. Such account balances include, but are not necessarily limited to, reserves maintained to satisfy reserve requirements. The Reserve Banks are also required to consider the portion of the branch's or agency's assets held in satisfaction of reserve requirements.

The Federal Reserve Act, as amended by the IBA, also subjects discount window lending to U.S. branches and agencies of foreign banks to any restrictions and limitations imposed by the Board. The Board has not imposed any specific limitations upon lending to branches and agencies. The Board has, however, imposed certain general conditions upon lending availability and terms for all borrowers. For example, the Board limits the availability of short-term adjustment credit to circumstances in which reasonable alternative sources of funds have been fully used (12 CFR 201.3(a)). Similarly, the Board limits the availability of other extensions of credit, such as lending to ease financial strains on a particular depository institution, to cases in which similar assistance is not reasonably available from other sources (12 CFR 201.3(b)(2)).

10. Are all U.S. branches and agencies of foreign banks not subject to criminal penalties such as bank fraud, embezzlement, false bank entries, misapplication of funds, and bribery as enumerated under Title 18 of the U.S. Code? Please explain.

The criminal code, Title 18 of the U.S. Code, defines "financial institution" to include insured U.S. branches of foreign banks (18 USC 20). U.S. branches of foreign banks that are not insured, as well U.S. agencies of foreign banks, are not included within the definition of "financial institution." Thus, to the extent that any provision of the code applies to financial institutions, insured U.S. branches of foreign banks are subject to criminal penalties but agencies and uninsured branches are not. The provisions of the criminal code that apply to financial institutions, and their officers, employees, directors and agents, include the provisions on bribery (18 USC 212, 213 and 215).

Other provisions of the criminal code, including the provisions on bank fraud (18 USC 1344), false entries (18 USC 1005), and embezzlement and misapplication of funds (18 USC 656), do not specify financial institutions as one of the types of institutions to which they apply but otherwise enumerate the list of institutions to which they apply. Although it is not entirely clear, it appears that the provisions on bank fraud apply to insured branches of foreign banks and federally-chartered branches and agencies of foreign banks. The bank fraud provisions do not apply to state-chartered agencies or uninsured, state-chartered branches. The provisions on false bank entries and embezzlement, which are also not entirely clear, appear to apply to insured branches of foreign banks. The provisions do not apply to agencies or uninsured branches of foreign banks.

11. Please explain the amendments your General Counsel drafted to ensure the U.S. branches and agencies are subject to the criminal penalties such as bank fraud, embezzlement, false bank entries, misapplication of funds, and bribery as enumerated under Title 18 of the U.S. Code?

The revisions to the criminal code were drafted in response to a request by the U.S. Attorney that the Federal Reserve prepare amendments to ensure that branches and agencies of foreign banks are subject to the same criminal sanctions as are U.S. financial institutions. The provisions of the code relating to crimes by banks, savings and loan associations and other financial institutions or by employees or examiners of these entities have developed on an ad hoc basis over time and there is little consistency in the usage of terms between provisions. Consequently, there are some inconsistencies in the coverage of financial institutions by the criminal code.

The draft amendments attempt to subject U.S. branches and agencies of foreign banks to the same provisions of the code that are applicable to banks. Section 20 of Title 18, United States Code, defines the term "financial institution" for purposes of the criminal code. As noted above in response to question 10, the definition of "financial institution" currently includes insured branches of foreign banks. The draft amendments add all branches and agencies to the definition of "financial institution." Thus, under this proposed amendment, any action by a financial institution that the code makes a crime would also be a crime when conducted by any U.S. branches or agencies of a foreign bank. Similarly, by virtue of this proposed amendment, actions by employees or examiners of branches or agencies or by other persons in connection with a branch or agency would be made a crime where the same action is a crime when taken in connection with a bank.

However, as noted in response to question 10, there are provisions of the criminal code that set out a specified list of types of institutions that are covered. The proposed amendments would add U.S. branches and agencies of foreign banks to the list of specified institutions in these provisions to ensure uniform coverage by the criminal code of all financial institutions. These other provisions include the provisions on bribery (which currently apply only to insured financial institutions) (18 USC 212 and 213), misuse of public funds by custodians (18 USC 648), theft by bank examiners (18 USC 655), theft or embezzlement by bank employees (18 USC 656), false certification of checks (18 USC 1004), falsification of bank reports or loan applications (18 USC 1005 and 1014), computer fraud (18 USC 1030), disclosure of confidential examination information (18 USC 1906), and bank robbery (18 USC 2113).

The amendments would also cover Edge and agreement corporations in the same manner as banks, branches and agencies. Because these Edge and agreement corporations are authorized to

conduct an international banking business in the United States, we believe it is appropriate to subject them to uniform coverage.

The proposed amendments seek to address specific examples of failure to cover institutions where we believe it is appropriate that they be covered. The proposed amendments do not attempt to present a comprehensive reconsideration of the provisions of the criminal code as they apply to financial institutions.

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U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED FIRST CONGRESS

2129 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515

August 23, 1990

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202 225-4247

Mr. Peter M. Philbin
 Deputy Superintendent of Banks
 and Chief Examiner
 State of New York
 Two Rector Street
 New York, New York 10006

Dear Mr. Philbin:

During your testimony before the House Banking Committee on August 9, 1990, I briefly mentioned that I would be writing you to get additional information on the State of New York's supervision and examination of state-chartered branches and agencies of foreign banks. I would be most appreciative if you could answer the following questions regarding this issue.

- 1.) What is New York State Banking Department's role regarding the U.S. branches and agencies of foreign banks?
- 2) Please explain the regulatory structure for such entities, including the State of New York's relationship with the Federal Reserve, the FDIC, and other state bank regulatory agencies.
- 3) Please provide financial information on the New York state-chartered U.S. branches and agencies of foreign banks including aggregate balance sheet and income statement data, number of branches and agencies and their total employees.
- 4) How many of these entities are insured by FDIC? What percentage of the aggregate liabilities of these entities are insured by the FDIC?
- 5) How often are these entities examined by the State of New York? How many examiners does the State of New York have specifically dedicated to examining these entities?

6) Please explain the enforcement authority of the State of New York as it pertains to the U.S branches and agencies of foreign banks.

7) This question concerns Banca Nazionale del Lavoro (BNL).

The U.S. headquarters of BNL are in New York.

A. How often did the State of New York examine BNL over the past five years?

B. Did the State of New York Banking Department ever examine any of the other BNL operations such as BNL-Atlanta? Please explain.

C. On what date was the State of New York notified of the BNL scandal?

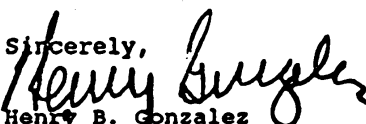
D. What was your departments role in the BNL investigation?

8) Are the New York state-chartered U.S. branches and agencies of foreign banks subject to criminal penalties such as bank theft, fraud, embezzlement, false bank entries, misapplication of funds, and bribery as enumerated under Title 18 of the U.S. Code?

Thank you for your time and consideration of this request. If you have any questions regarding this request, please feel free to contact Mr. Dennis Kane of my staff at (202) 225-4247.

Your cooperation is most appreciated, and I look forward to your timely reply.

With best wishes.

Sincerely,

 Henry B. Gonzalez
 Chairman

HBG:dk



STATE OF NEW YORK
BANKING DEPARTMENT
TWO Rector STREET
NEW YORK, N.Y. 10006

JILL M. CONSIDINE
SUPERINTENDENT OF BANKS

October 10, 1990

Honorable Henry B. Gonzalez, Chairman
Committee on Banking, Finance and Urban Affairs
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Pursuant to your letter of August 23, 1990 regarding the State of New York's supervision and examination of state-licensed branches and agencies of foreign banks, I am pleased to provide the following information.

1. The New York State Banking Department is the primary regulator of the 208 state-licensed branches and agencies of foreign banks operating in New York. The aggregate resources of these institutions comprise approximately 70% of the assets of all branches and agencies of foreign banks in the United States.

The regulatory process in New York begins with the initial approval of the license. All organizations must receive the approval of the New York State Banking Board before commencing business. The screening process involves an extensive analysis of such factors as the business purpose of the proposed institution, the financial history and standing of the bank, home country supervision, the character and ability of proposed management, forecasts of expected operations, and the public convenience and advantage to be served.

Once an entity is established in New York, the on-going supervisory process utilizes a combination of on-site examinations, visitations and off-site monitoring. The scope of the review of foreign bank offices includes an evaluation of assets, credit administration, credit documentation, internal operating procedures and controls, external and internal auditing, funding sources, off-balance sheet activities and compliance with laws and regulations. In

Honorable Henry B. Gonzalez, Chairman
Committee on Banking, Finance
and Urban Affairs

page 2

October 10, 1990

addition, an evaluation of local management and parent bank supervision is made.

The report format utilized in the examination of branches and agencies of foreign banks was developed jointly with federal bank regulatory agencies. When an examination is completed, copies of the report reflecting the examiner's findings are supplied to the licensed entity in New York as well as to the head office of the bank overseas. Findings are also shared with the Federal Deposit Insurance Corporation, in the case of insured institutions, and the Federal Reserve Bank of New York in order to assist those agencies in fulfilling the supervisory mandate imposed by the International Bank Act.

2. The operations of branches and agencies of foreign banks are governed by Article V of the New York Banking Law, supplemented by various regulations and supervisory pronouncements. Some of the more significant aspects of the regulatory structure include the following:

In accordance with the New York Banking Law, a foreign bank may not maintain both an agency and a branch in New York State and the choice of organizational form depends upon the type of business it wishes to conduct.

Foreign bank branches possess investment and loan powers virtually identical with those of a commercial bank. As stipulated in the New York Banking Law, lending limits are the same as those applicable to a state-chartered bank or trust company with the branch limits based on head office capital converted to its U.S. dollar equivalent.

Foreign bank branches that have selected New York as the home state under the International Banking Act may accept deposits, subject to certain restrictions. A branch of a foreign bank is exempt from FDIC insurance requirements if its retail deposits do not exceed 4 percent of total third-party deposits based on monthly averages. Moreover, the branch may not solicit deposits from the general public and must notify each account holder of the noninsured status.

In New York, non-insured branches are required to pledge assets with a depository approved by the Superintendent of Banks in an amount not less than 5 percent of liabilities, excluding amounts due to other offices of the bank and wholly-owned subsidiaries. Section 202-b(1) of the Banking Law stipulates certain high quality securities which may be deposited and Part 322 of the Superintendent's Regulations adds top rated commercial paper, certificates of deposit,

Honorable Henry B. Gonzalez, Chairman
Committee on Banking, Finance
and Urban Affairs

page 3

October 10, 1990

bankers' acceptances and reserves held at the Federal Reserve Bank to the list.

In the event the Superintendent were to take possession of an uninsured foreign bank branch, the pledged assets serve as an immediate liquid resource.

Under Part 346 of the FDIC Rules and Regulations, a branch is required to be insured if it is engaged in "domestic retail deposit activity" and is located in a state which requires a bank to have deposit insurance whenever the bank accepts deposits from the general public. New York is such a state.

The powers of agencies of foreign banks are similar in many respects with those of branches, with the principal distinction involving the ability to accept deposits. The Banking Law generally bars agencies from receiving deposits. However, there are three significant exceptions to the general prohibition:

- Agencies have the authority to maintain credit balances incidental to or arising from the exercise of their lawful powers.
- The statute also permits agencies to issue large-denomination obligations (i.e. \$100 thousand or more) to corporations, partnerships and unincorporated associations. These obligations may be evidenced by a promissory note, a certificate of deposit, a statement or a book entry. Thirty days before the initial issuance of large-denomination obligations the agency must notify the Superintendent of such intention.
- The Banking Law also permits a foreign agency to accept deposits from non-U.S. citizens who are non-residents. The amounts may be less than \$100 thousand and may be taken from individuals. However, each depositor must be notified that accounts are not insured by the FDIC. In fact, agencies are not eligible for FDIC insurance.

While the investment and loan powers are essentially the same as a branch's, agencies are not subject to a legal lending limit. In addition, there is no asset pledge requirement.

Foreign banks operating agencies and branches are expected to conform with the International Convergence of Capital Measurement and Capital Standards promulgated by the Basle Committee.

Honorable Henry B. Gonzalez, Chairman
Committee on Banking, Finance
and Urban Affairs

page 4

October 10, 1990

Foreign branches and agencies are both authorized to conduct fiduciary activities. However, the exercise of such powers must be specifically approved by the Superintendent.

Branches and agencies are subject to asset maintenance requirements, which are imposed by the Superintendent on a case-by-case basis as circumstances warrant. This provision of the Banking Law and General Regulations of the Banking Board requires that an institution maintain eligible assets in excess of third party liabilities as a means of protecting creditors and for the benefit of the public. In general, the concept of eligibility extends to those assets for which there is a reasonable expectation of liquidation on a timely basis. The specific qualifications for eligibility for most classes of assets are defined in the Superintendent's Regulations. Amounts due from the head office, other non-U.S. offices and wholly-owned subsidiaries within the parent organization are not eligible. Thus, imposition of asset maintenance precludes a New York branch or agency from being a net provider of funds to non-U.S. segments of its organization.

Asset maintenance is typically imposed in cases when there is a perceived weakness in the financial condition of the bank or when circumstances in the home country may adversely affect the New York office. At this time only 33 branches and agencies are subject to the asset maintenance requirements.

As indicated previously, the Banking Department furnishes copies of all branch and agency examination reports to the Federal Reserve Bank of New York. The FDIC receives copies for all insured institutions. In general, the Banking Department maintains a close relationship with Federal regulatory authorities.

With respect to other state regulatory agencies, state regulators in California, Florida, Illinois, Georgia, Michigan and Washington recently joined New York in an agreement to exchange information about the foreign banks operating within their borders, whenever problems are encountered. Examples of information to be shared include: financial condition, examination ratings, business practices, compliance record and the bank's record with its home country supervisor and its parent organization. All information is to be shared on a confidential basis.

This initiative was established in response to the entry of foreign banks into new markets and serves as a means of further strengthening the State supervision system. Efforts are also being made to organize the supervision of a foreign

Honorable Henry B. Gonzalez, Chairman
Committee on Banking, Finance
and Urban Affairs

page 5

October 10, 1990

bank so that all its U.S. offices are examined at the same time. It is also anticipated that other states will sign this agreement. A similar supervisory initiative has been launched with respect to multi-state domestic bank holding companies.

3. Aggregate balance sheet data for the 204 foreign branches and agencies operating as of June 30, 1990 is presented below. Aggregate income data is not routinely collected for branches and agencies. Profitability data for individual institutions is obtained and analyzed during the examination of these offices. Likewise, employment statistics are not routinely reported. However, it is estimated by the Institute of International Bankers that foreign banks in New York employ approximately 40,000 people.

**Aggregate Balance Sheet Data
New York State Licensed Branches and Agencies
As of June 30, 1990**

(In Millions)

Cash & Balances With Other Banks	105,710
Bonds & Corporate Stocks	35,404
Federal Funds Sold	12,013
Loans & Overdrafts	157,810
Customers' Liability On Acceptances	20,495
Other Assets	15,354
Net Due From Related Depository Institutions	<u>45,436</u>
Total Assets	<u>392,222</u>
 Demand Deposits	 6,291
Time & Savings Deposits	193,229
Federal Funds Purchased	50,608
Other Borrowed Money	71,596
Liability On Acceptances	26,741
Other Liabilities	13,843
Net Due To Related Depository Institutions	<u>29,914</u>
Total Liabilities	<u>392,222</u>

Honorable Henry B. Gonzalez, Chairman
Committee on Banking, Finance
and Urban Affairs

page 6

October 10, 1990

4. As of June 30, 1990, only 16 of the foreign banks operating branches and agencies maintained FDIC-insured offices. Of the aggregate liabilities of all 294 state-licensed institutions, 0.61% are insured by the FDIC.
5. Formal, comprehensive examinations are supplemented by periodic visits by Department personnel which provide an update of the condition of the branch or agency since the previous examination. These visits are conducted by representatives of the Banking Department's Foreign Banks Division, who are responsible for the relationship with the individual institutions. This unit is devoted solely to the supervision of foreign institutions and consists of a deputy superintendent of banks and a staff of 24. Depending upon the condition of the entity as reflected in its rating, the strength of the parent and the assessment of country risk, examinations are conducted on 12 to 24 month cycles. Entities that are not on a 12 month examination cycle are subject to special visitations at periodic intervals.

The examination function for all state licensed or chartered banking organizations is performed by the Department's Examinations Division which draws from a pool of approximately 200 field bank examiners.

6. The Superintendent of Banks has a broad range of options in dealing with a problem situation, governed by its severity and any other mitigating factors. In a less serious instance the matter may be handled by a disciplinary letter to the institution and in the other extreme by revocation of the license. Other options include an informal agreement, a memorandum of understanding and a cease and desist order. The parent bank would be notified in all cases and may be asked to participate if the situation warranted such action. As discussed earlier, an asset maintenance requirement may be imposed.

The Superintendent has the power to assume control of a foreign branch or agency. This would occur only under extreme circumstances after other measures had been exhausted. This type of action has been rare and has most often occurred when the parent bank has failed or has experienced severe difficulties.

- 7(a) The New York State Banking Department examined the New York Branch of Banca Nazionale del Lavoro (BNL) in 1986, 1987, 1988 and 1989. The 1990 examination has not yet commenced.

Honorable Henry B. Gonzalez, Chairman
Committee on Banking, Finance
and Urban Affairs

page 7

October 10, 1990

- (b) The New York State Banking Department has not examined any of the offices of BNL outside New York. The Department has no jurisdiction over offices of foreign banks located in other states. The examination of a branch or agency entails the review of assets, liabilities and other matters pertaining to the New York entity.
- (c) On the afternoon of Friday, August 4, 1989, the Department was informed by the Federal Reserve Bank of New York that BNL was under investigation by the US Attorney's office in Atlanta for initiating transactions from the Atlanta agency that were not recorded on its books.
- (d) At 5:00 PM on Friday, August 4, 1989 the Federal Reserve Bank of New York commenced a surprise examination of the New York branch of BNL. On Saturday, August 5, 1989 Deputy Superintendent P. Vincent Conlon, representing the New York State Banking Department, met with BNL New York management. Head office management in Italy was contacted and on Sunday, August 6 the Vice Chairman of BNL flew to New York and met with Deputy Conlon and Federal Reserve Bank officials. He subsequently journeyed to Atlanta. Meanwhile a commitment was secured from Bank of Italy to provide whatever liquidity might be necessary to support the activities of BNL in the United States in the event of a negative reaction to publication of the matter.

New York State examiners joined the Federal Reserve examiners on Monday, August 7, 1989 in order to perform a joint examination focusing on the impact of the problems in Atlanta on the New York branch and any involvement the New York branch might have in the Atlanta situation.

- 8. Title 18 would not apply to New York State chartered branches and agencies except in the case of a branch whose deposits are insured by the Federal Deposit Insurance Corporation. However, the enumerated criminal acts would be subject to the provisions of the New York State Banking Law and the Penal Law.

We hope our response has fully addressed all your questions. If we can be of further assistance please let us know.

Very truly yours,



Peter M. Philbin
Deputy Superintendent of Banks
Foreign Commercial Banks Division

JEM/db

Department of Banking and Finance

2990 Brandywine Road, Suite 200

Atlanta, Georgia 30341-5565

Joe Frank Harris
Governor

F.B. "Jack" Dunn
Commissioner

October 1, 1990

Hon. Henry B. Gonzalez, Chairman
Members, Committee on Banking, Finance,
and Urban Affairs
U. S. House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Ladies and Gentlemen:

I am pleased to provide the following comments relative to the Georgia Department of Banking and Finance (Georgia) and its supervision of international banking presence in the State of Georgia specifically as it pertains to the Banca Nazionale Del Lavoro, Atlanta Agency. Due to schedule conflicts, I am unable to personally appear before the committee; however, John B. Kline, Deputy Commissioner for Supervision, is available to the committee in my absence.

These written comments and the testimony of Mr. Kline are offered for whatever assistance they may be to the committee in carrying out its oversight responsibilities; however, they are necessarily limited because of statutory restrictions regarding the confidentiality of bank examination records and ongoing criminal investigations.

1. (a) Explain the State of Georgia's role in regulating the U. S. operations of BNL-Atlanta.

Under the dual licensing system established under the International Banking Act, foreign banks may conduct business within a given state to the extent that such state's statutes permit. Georgia laws permit foreign bank presence as an agency (non-depository banking office) or as a representative office (business solicitation office). BNL elected to establish an agency and had the choice of doing so under either a state or federal license. Federal regulatory supervision for a federal license holder is provided through the Office of the Comptroller of the Currency (as with national banks). Federal regulatory supervision for state license holders, to the extent applicable, is through the Federal Reserve Board with the primary regulatory supervision coming from the licensing state regulatory

Hon. Henry B. Gonzalez
October 1, 1990
Page 2

..authority. BNL elected to obtain a state license and has operated its agency in Atlanta under such license since March 10, 1980.

(b) What type of oversight did the State of Georgia conduct of BNL-Atlanta operations over the past five years?

Georgia has conducted annual examinations of BNL since it commenced business in Atlanta. Such examinations have been conducted in accordance with examination procedures used in the supervision of domestic banks and consistent with standard examination methods and procedures utilized by federal examining authorities. These procedures are, of course, modified to reflect specific differences in the financial structure of a non-deposit taking institution. Representatives of the Federal Reserve Bank of Atlanta, Division of Supervision and Regulation, are invited to participate in all such examinations. The Department also utilizes semi-annual reports of condition and reports by BNL's external auditors to monitor interim developments consistent with the regulatory supervision given domestic institutions.

(c) How often did the State of Georgia examine BNL-Atlanta operations?

Annually.

(d) What type of examinations were conducted?

Full scope examinations utilizing techniques and procedures consistent with those utilized by Georgia and federal regulatory agencies in the supervision of domestic financial institutions but modified to reflect unique features of international bank operations.

(e) Did BNL sign a supervisory agreement with the State of Georgia? Why or why not?

No. Prior to the 1989 examination/investigation no irregularities warranting such disciplinary action had previously been observed. As a result of the 1989 examination/investigation BNL management undertook certain actions both independently and in cooperation with regulatory authorities to address the findings of internal auditors and examining personnel.

(f) Are you confident that BNL has corrected the problems that led to this predicament?

BNL has reported changes within its internal audit and corporate structure which should add further safeguards against reoccurrence of the recent irregularities. The existence and effectiveness of these changes will be subject to verification at the next examination of the agency. It should be recognized that a fundamental cause for the events at BNL, assuming no corporate intent, was a breakdown of the basic ingredient of any security system - dual control. Significant collusion and a highly sophisticated scheme to conceal the illegal

Hon. Henry B. Gonzalez
 October 1, 1990
 Page 3

activities were successful to a point. This is frequently true when the perpetrators have the ability to direct their full attention to the concealment and auditors have a limited amount of time and resources to devote to detection. Pursuit of audit exceptions and the unwieldy size and complexity of the scheme are thought to be the reasons the affair finally surfaced, however. The network of internal control, internal audit, external audit, and regulatory overview ultimately caused the irregularities to be revealed despite extraordinary efforts to conceal them.

2. In regulating the state chartered U. S. branches and agencies of foreign banks, please explain the coordination that is supposed to occur with the Federal Reserve Bank of Atlanta, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System.

Regulation of international banking agencies operating in Georgia is fully coordinated with the Federal Reserve Bank of Atlanta. The Federal Reserve sends a representative on virtually all examinations and all important reports and correspondence is exchanged. Supervisory meetings with foreign bank representatives are also coordinated for joint participation. Coordination within the Federal Reserve System is the responsibility of FRB and questions regarding such coordination should be directed to that agency. The current examination and supervision program has been in place relative to the State of Georgia since 1976.

3. (a) Please provide data on the number of branches and agencies of foreign banks supervised by the State of Georgia including balance sheet and income statement data.

Attached please find excerpts from the 1989 Annual Report of the Georgia Department of Banking and Finance reflecting the international bank agencies and representative offices operating in Georgia as of December 31, 1989. As a result of developments in eastern Europe and the evolution of the European Community, many foreign banks are reassessing their worldwide operations and regional focus. This reassessment is expected to cause some internal restructuring and resource reallocation within each of the foreign banks which will effect their U. S. operating structure and, in some cases, their continued U. S. presence. Detailed financial information is reported by international bank agencies utilizing forms and procedures prescribed by the FRB. Current data should be requested directly from the FRB.

- (b) How many examiners has the State of Georgia dedicated to examining these entities?

Georgia's full field examination staff of approximately 80 professional examiners having an average experience level of 8 1/2 years is available for examination of international banks to the extent needed. Most examinations are handled by an examination district staff of 15 examiners.

Hon. Henry B. Gonzalez
 October 1, 1990
 Page 4

(c) How often are these entities typically examined?

Only those international banks licensed and operating at the agency level require financial examinations. Representative office activity can be monitored for compliance through a limited scope visitation since all balance sheet activity is handled through another U. S. office. Agencies are examined annually unless findings dictate a greater frequency.

(d) What type of training do these examiners receive?

All state examiners are familiar with the basic statutory provisions and possess the credit examination and financial analysis skills essential to examination of the books and records of a financial institution, including the international departments of domestic banks and international bank agencies. These skills are developed through on-job training, in-house training programs, Conference of State Bank Supervisors and federal regulatory schools and seminars, and industry sponsored schools and seminars. Senior members of a skilled examination team have been accorded specific training related to international banking transactions through on-job training as well as classroom training utilizing federal regulatory and industry sponsored schools and seminars.

4 Is the regulatory structure governing the U. S. branches and agencies of foreign banks adequate or is the fragmented structure that now exists (i.e., the regulation and examination of these entities is divided among the OCC, FDIC, and Federal Reserve as well as 50 states) prone to breakdowns such as the one that occurred in the BNL-Atlanta case?

Georgia rejects the premise that the BNL-Atlanta case was the result of any regulatory breakdown. Nothing other than virtually constant, on-site regulatory presence could have enabled regulatory authorities to become aware of the irregularities at an earlier date. Earlier communication from BNL internal auditors to regulatory authorities might have brought the matter to light a little sooner. Communication of knowledge alleged in the media to be possessed by non-regulatory agencies of the federal government to bank regulatory agencies may have brought the matter to light sooner. Regulatory coordination prior to the events coming to light could not have been better and there is not evidence that a different structure would have brought about earlier revelation of the irregularities or prevented them from occurring.

The bank regulatory structure was never designed to provide front line fraud detection. It has an overseers role. As soon as evidence came to regulatory attention, the existing networks were activated to provide an appropriate response to the developing problem. The FRB provided coordination within the federal system and Georgia provided such coordination to the appropriate states under the Subcommittee on International Regulation of the Conference of State Bank Supervisors.

Cross jurisdictional problems that occurred during the investigation of the BNL-Atlanta affair could be addressed using experiences gained

Hon. Henry B. Gonzalez
 October 1, 1990
 Page 5

during this unique event. However, legislative attention is not clearly needed.

5. Do you have any recommendations for improving or streamlining the regulation and examination of these entities?

At the local level, we would have no recommendations for improvement in the process inasmuch as full cooperation and consultation has always been practiced. It would be most productive, however, for annual supervisory meetings between all state regulators who have international branch and agency supervisory responsibilities and the appropriate federal representatives within the Federal Reserve System to be held. In the past, state participation has been limited by the FRB.

The Conference of State Bank Supervisors proposes a number of changes in the state/federal relationship which are designed to enhance the regulatory oversight and Georgia fully supports those proposals.

Do you have any suggestions for improving coordination between the state banking agencies and the federal bank regulatory agencies?

During the investigation of the BNL-Atlanta matter, the state was severely limited in its access to information being developed by or at the request of the U. S. Attorney's Office. At times communication seemed to be a "one-way street." Georgia is now and has always been willing to provide technical assistance in the investigation and prosecution of criminal matters occurring within institutions it supervises. The state has the legal obligation to pursue those investigations and prosecutions in its own right. To avoid duplication of effort, however, Georgia generally defers to federal authorities having competent jurisdiction and which have already become involved in an investigation. Because of the state's statutory responsibility, such cooperation must be as full partners and not simply as a convenient resource. In the case of BNL-Atlanta, the state's involvement was reported to have been limited by the U. S. Magistrate but further limitations appear to have been imposed through the U. S. Attorney's office.

Georgia appreciates the opportunity to address the BNL-Atlanta affair before the Committee. We believe that the developments at BNL-Atlanta reflect more on how the regulatory system has worked, not failed. It certainly can be improved and reaction to such crisis situations can be better managed. Problems appear to have been greatest, however, in the management of the crisis and communications from agencies other than those directly involved in bank regulation to the bank regulatory system. Perhaps this should be the focus of the Committee's attention.

Yours truly,



E. D. "Jack" Dunn

EDD:rb

INTERNATIONAL BANK AGENCIES

ATLANTA AGENCY & ADDRESS	FOREIGN LOCATION	AGENT, TELEPHONE NO., AND DATE LICENSE ISSUED	*GEORGIA ASSETS (In Thousands)
Algemeene Bank Nederland, N.V. Suite 1200 One Ravinia Drive Atlanta, GA 30346-2103	Amsterdam, The Netherlands	Jerome A. Wolfe Manager 404-396-0066 June 24, 1977	148,447
Banca Nazionale Del Lavoro Suite 2000 235 Peachtree Street, NE Atlanta, GA 30303	Rome, Italy	Luciano Silvestri First Vice Pres. & Mgr. 404-581-0143 February 09, 1982	2,420,919
Barclays Bank PLC 1201 West Peachtree Street, NE Suite 3650 Atlanta, GA 30309	London, England	Samuel G. Barnes Vice President & Manager 404-898-9800 June 11, 1976	
Bayerische Vereinsbank AG 400 Colony Square, Suite 1150 1201 Peachtree Street, NE Atlanta, GA 30361	Munich, West Germany	Bruce A. Offenloch Vice President & Manager 404-873-6500 December 01, 1980	19,279
Canadian Imperial Bank of Commerce Suite 650 200 Galleria Parkway, NW Atlanta, GA 30339	Toronto, Ontario, Canada	Gordon C. Harrison General Manager 404-955-8989 April 05, 1978	401,084
Commerzbank Aktiengesellschaft Suite 1720 1360 Peachtree Street, NE Atlanta, GA 30309	Frankfurt, West Germany	Peter K. Thiels Manager 404-873-6868 October 31, 1978	174,027
Credit Lyonnais Suite 2210 235 Peachtree Street, NE Atlanta, GA 30303	Paris, France	Charles H. Heidsieck Vice President & Manager 404-524-3700 November 06, 1980	
Credit Suisse Suite 1601 2 Peachtree Street, NW Atlanta, GA 30383-2801	Zurich, Switzerland	W. Pat Fischer Dir. of Corp. Relations 404-577-6100 November 27, 1978	
Creditanstalt-Bankverein Suite 1680 Two Ravinia Drive Atlanta, GA 30346	Vienna, Austria	Robert M. Birlinger Vice President 404-390-1850 October 13, 1988	
DG BANK-Deutsche Genossenschaftsbank Suite 2510, Cain Tower 229 Peachtree Street, N.E. Atlanta, GA 30303	Frankfurt, West Germany	Hayo Willas Senior VP and Manager 404-524-3966 May 31, 1989	6,201

*Agencies with no assets operate as Representative Offices only

ATLANTA AGENCY & ADDRESS	FOREIGN LOCATION	AGENT, TELEPHONE NO. AND DATE LICENSE ISSUED	*GEORGIA ASSETS (In Thousands)
Kredietbank, N.V. Suite 2936, First Atlanta Tower 2 Peachtree Street, NE Atlanta, GA 30383	Brussels, Belgium	Pieter Vandendriessche Senior Representative 404-688-3470 March 20, 1980	
National Bank of Canada Suite 800 200 Galleria Parkway, NW Atlanta, GA 30339	Montreal, Quebec, Canada	William R. O'Conner Vice President 404-980-0588 April 10, 1985	
National Westminster Bank PLC Suite 2701 245 Peachtree Center Avenue Atlanta, GA 30303	London, England	Richard J. Freedman Vice President 404-584-7388 July 03, 1984	
Nederlandsche Middenstandsbank NV Suite 1250 200 Galleria Parkway, NW Atlanta, GA 30339	Amsterdam, The Netherlands	Patricia B. Buck (Temporary) Vice President 404-956-9200 November 03, 1987	
Standard Chartered Bank Suite 400 Two Ravinia Drive Atlanta, GA 30346	London, England	John C. M. Menzies Regional Manager South 404-396-2900 October 19, 1981	121,447
Swiss Bank Corporation 285 Peachtree Center Avenue Suite 2300 Atlanta, GA 30303	Basle, Switzerland	Richard B. Land Vice President & Manager 404-522-1600 July 14, 1977	167,158
The Bank of Nova Scotia Suite 650 55 Park Place Atlanta, GA 30303	Toronto, Ontario, Canada	D. Norman Gillespie Agent 404-581-0807 May 27, 1977	1,731,653
The Dai-ichi Kangyo Bank, Limited Suite 2400 285 Peachtree Center Avenue Atlanta, GA 30303	Tokyo, Japan	Masaaki Suzuki General Manager 404-581-0200 December 01, 1987	258,836
The Fuji Bank, Limited Marquis One Tower, Suite 2100 245 Peachtree Center Avenue, NE Atlanta, GA 30303	Tokyo, Japan	Shoji Kurita General Manager 404-653-2100 December 09, 1987	236,089
The Royal Bank of Canada Georgia Pacific Building 133 Peachtree Street, Suite 4630 Atlanta, GA 30303-1821	Montreal, Quebec, Canada	Thomas L. Gleason Office Manager 404-860-5000 March 23, 1989	

*Agencies with no assets operate as Representative Offices only

INTERNATIONAL BANK AGENCIES

ATLANTA AGENCY & ADDRESS	FOREIGN LOCATION	AGENT, TELEPHONE NO. AND DATE LICENSE ISSUED	*GEORGIA ASSETS (In Thousands)
The Sanwa Bank, Limited Georgia Pacific Center, Suite 4750 133 Peachtree Street, N.E. Atlanta, GA 30303	Tokyo, Japan	Shinichi Hiraga General Manager 404-586-6880 November 14, 1984	761,570
The Sumitomo Bank, Limited Suite 3210 133 Peachtree Street Atlanta, GA 30303	Osaka, Japan	Hasao Harada General Manager 404-526-8500 August 04, 1987	293,664
The Tokai Bank, Limited 285 Peachtree Center Avenue, N.E. Marquis Two Tower, Suite 2802 Atlanta, GA 30303	Nagoya, Japan	Tomio Tanaka General Manager 404-880-0000 October 10, 1989	

*Agencies with no assets operate as Representative Offices only

INTERNATIONAL BANK REPRESENTATIVE OFFICES - 1989

ATLANTA OFFICE & ADDRESS	FOREIGN LOCATION	REPRESENTATIVE, TELEPHONE NO., AND REGISTRATION DATE
Credit du Nord - Atlanta 8 Piedmont Center Suite 414 Atlanta, GA 30305	Paris, France	Brenda O. Head Vice President & Manager 404-233-3427 August 31, 1989
Lloyds Bank PLC Marquis Two Tower, Suite 2301 285 Peachtree Center Avenue Atlanta, GA 30303	London, England	William N. Pety Managing Officer 404-524-6344 January 03, 1989
National Australia Bank Limited Atlanta Rep Office 225 Peachtree Street Suite 2200 - South Tower Atlanta, GA 30303	Melbourne, Australia	P. Scott Bennett Senior Vice President 404-688-5016 January 03, 1989
The Bank of Tokyo, Limited 5050 Georgia-Pacific Center 135 Peachtree Street, N.E. Atlanta, GA 30303	Tokyo, Japan	Kazuhisa Konoma Managing Officer 404-577-2960 January 03, 1989
The Industrial Bank of Japan, Ltd. Atlanta Rep Office 235 Peachtree St., N.E. Suite 1500 Atlanta, GA 30303	Tokyo, Japan	Ken Kiyoshi Chief Representative 404-524-8770 January 03, 1989
The Long-Term Credit Bank of Japan Ltd. Suite 2801, Marquis One Tower 245 Peachtree Center Avenue, N.E. Atlanta, GA 30303	Tokyo, Japan	Yasuyoshi Tsuji Managing Officer 404-659-7210 January 03, 1989
The Mitsui Bank, Limited 230 Peachtree Street Suite 2360 Atlanta, GA 30303	Tokyo, Japan	Masayoshi Ohtori Managing Officer 404-523-9831 January 03, 1989
The Taiyo Kobe Bank, Limited One Atlantic Center, Suite 4950 1201 West Peachtree Street, N.E. Atlanta, GA 30309	Kobe, Japan	Shigemoto Morisaki Chief Representative 404-672-6101 March 13, 1989

INTERNATIONAL BANK REPRESENTATIVE OFFICES - 1989		
ATLANTA OFFICE & ADDRESS	FOREIGN LOCATION	REPRESENTATIVE, TELEPHONE NO., AND REGISTRATION DATE
The Yasuda Trust and Banking Company, Limited 285 Peachtree Center Avenue, N.E. Suite 2100, Marquis Two Atlanta, GA 30303	Tokyo, Japan	Keisuke Miyata Managing Officer 404-594-7807 January 03, 1989
Vereins-Und Westbank AG Representative Office 229 Peachtree Street Suite 2300 Atlanta, GA 30303	Hamburg, West Germany	David N.G. Mulrhead Managing Officer 404-688-5430 January 03, 1989

[Translation - Italian]

SENATE OF THE REPUBLIC

SPECIAL COMMITTEE

on the case of the Banca Nazionale del Lavoro's branch in Atlanta

Tuesday, May 22, 1990

2nd Session

Under the Chairmanship of Chairman Carta

The Minister of the Treasury takes the floor.

The session begins at 3:35 p.m

The Chairman, Senator Carta, thanks Minister Carli for having accepted the invitation extended by the Office of the Committee Chairman last May 9. Inasmuch as the Minister had already referred in Parliament, both before the Chamber of Deputies and before the Senate, to the matter that involved the Banca Nazionale del Lavoro [BNL] with its branch in Atlanta, the Committee has thought that the hearing of the Minister should constitute its first act because he has more recent facts of record in the investigation that is underway and in what has emerged with regard to the case under examination.

He warns, furthermore, that on May 9, 1990, the documentation submitted by the Minister of the Treasury, concerning the beneficiaries of the illicit operations by the Atlanta branch, was sent to the Committee by the Office of the President of the Senate.

He further recalls that, since this is the first session of the committee, after its establishment, its nature and tasks were established by a vote of the Assembly of the Senate on January 24, 1990. The proposal accepted on that date by the Assembly was to suspend the examination of the proposal for a parliamentary inquiry until September 30 of this year, setting up in the meantime a special committee provided with the fact-finding investigative powers of the standing committees to go into depth and complete the findings of fact that have already been made by the Finance and Treasury Committee for passing them along later to the Senate for the possible renewal of the examination of the parliamentary inquiry proposal. He thus yields the floor to Minister Carli.

Minister Carli starts off by saying that the facts which emerged from the administrative investigation ordered by the banking oversight organization on the matters relative to the Atlanta branch of the BNL and the news deriving from the other available sources of information have constituted the object of preceding communications to the Chamber of Deputies on September 20, 1989 and to the Senate Finance and Treasury Committee on September 14, October 24, November 16 and December 14, 1989. It is sought to recall these communications by making a summary that bears in mind a more complete overall picture.

In the attempt to assure Parliament of the most ample awareness of the facts - availing itself of the procedure which allows the governor of the Banca d'Italia (Bank of

Italy - BDD to refer to the Minister of the Treasury as Chairman of the Inter-ministerial Committee for Credit and Savings (CICR), the data and the news obtained by Oversight, protected by a rigorous duty of confidentiality - the Minister, on September 29, 1989, answered questions presented by the parliamentary groups. In particular he referred to the development of the facts, to the fraudulent ways whereby the immense banking credits to Iraq were set up and to the techniques used for the outlays of the funds. Subsequently, on October 24, 1989, the Minister provided further information and expressed further evaluations before the Senate Finance and Treasury Committee, which in relevant session had under examination the proposal for a parliamentary investigation put forth by Senator Pecchioli and others.

On the occasion, the Minister emphasized the substantial coincidence between what was being proposed to investigate in a parliamentary session and what was investigated in the appropriate sessions. In confirmation of the adequateness of the investigations underway in satisfying the informative requirements of Parliament, the Minister surrendered to the aforesaid Committee, during the course of the November 16 session, detailed lists of the financing operations that were abusively set in place by the Atlanta branch with Iraqi counterparts, from which it is possible, within the limits allowed by the techniques used for the expenditures, to single out the beneficiaries of the operations and the merchandise whose exportation to Iraq was financed.

Having pointed out the opportunity to take stock of the events that took place in that time, the Minister thus recalls along essential lines the affair as it emerged from the inspections conducted by the BDI and from the information rendered by the Bancoper itself, with reference to the aspects that have aroused the biggest questions: the abnormal operations carried out by the Atlanta office, the position of the central offices and other organizational departments of the BNL in the affair, the business context in which the irregularities came to fruition.

Minister Carli observes that the inspections conducted at the Atlanta office of the BNL from August 7, 1989 to November 10, 1989 have made it clear that the activity was carried out, particularly in the last three-year period, for the purpose of relevant affairs, the fruit of autonomous initiatives in credit matters that were abusively taken by the director of the branch.

The same initiatives - carried out in a context of administrative and accounting disorder, with varied contrivances, thefts and forgeries aimed at concealing descriptions and purposes of the operations - have involved relevant economic-financial implications.

Against clean and signed credits to Iraqi counterparts and not regularly recorded in the accounting department on July 31, 1989 in the amount of 921 million dollars altogether, the easy terms concealed from the mother branch and from the internal and external oversight bodies, which subsequently emerged on August 4, turned out to be worth 2.867 billion dollars, related to: a) 1.798 billion dollars cash outlay to the Central Bank of Iraq (CBI)(1.017 billion dollars) and to the Rafidain Bank of Baghdad (781 million dollars), b) 520 million dollars, commitments deriving from confirmed letters of credit, in whole or in part unused, issued by the CBI; c) 49 million dollars, cash outlays to diverse beneficiaries, but attributed by the Atlanta branch to Rafidain; d) 500 million dollars, other cash and signed credits to diverse customers and banks.

The outlays to the CBI (1.017 billion dollars) took place on the basis of four "agreements" entered into with Iraqi government agencies for a total of 2.155 billion dollars, according to the techniques often described, which provided for direct payment to the exporters by the branch (option "A"; 216 million dollars), or else what was through transfers drawn upon instructions of the CBI in favor of various banks (option "B"; 693 million dollars) or, even, through transfers of funds to the CBI and upon verbal request, through the Irving and Mantrust Banks in New York (option "C", not expressly provided for by the agreements, 107 million dollars).

The credits to the Rafidain Bank amounted to 781 million dollars, of which 706 were for outlays to help American exporters of farm products, assisted by the collateral (?) of the Commodity Credit Corporation which, however, is conducting investigations into the regularities of the subordinate business operations.

Among the further irregular outstanding debts at point d), the concessions of cash and signature credits for a total amount of 442 million dollars, do not concern Iraqi counterparts, although some companies that benefitted turned out to be among those which, in other instances, were recipients of the outlays to the Central Bank of Iraq.

Minister Carli remarks at this point that the inquiries have permitted the reconstruction of some of the operational techniques used to conceal the irregular operations. These materialized in the manipulation of some accounts, in keeping the administrative and accounting documents in places other than the bank's offices, in the falsification of some confirmations requested of correspondents at an oversight session by Internal Auditing of New York, in the removal of the official collection of other documents. The ways of recording the irregular operations left some traces in the branch's accounting office and, thus, they would not have been able to escape more incisive internal supervision, as is also shown by the investigations of the branch conducted by the U.S. authorities.

The numerous accounting expedients and artifices aimed at concealing the operations placed the person in charge of the Atlanta branch in a position of uncontrolled autonomy beyond the limits allowed by the operational discipline in force at the BNL; in such a situation, interests not compatible with those of the BNL could be pursued. It is significant that, from the analysis conducted on the movements that concerned the "backup accounts" used for handling the relations with the Central Bank of Iraq and the Rafidain Bank - on those regarding other accounts, among which the account opened in the name of "Entrade," a New York company with which Mr. Drogoul might have had convergent interests, stands out because of its anomaly - debit entries appear whose nature and purpose it has not been altogether possible to clarify.

The speaker then states that along the lines of the role of the central offices and other organizational departments of Bancoper in the affairs that took place at the Atlanta branch, from the oversight investigations facts emerge that confirm contacts between Mr. Drogoul and employees forming part of the Home Office with regard to some of the operations conducted by the branch in question, revealed to be irregular; however, no facts emerged from which it shows that the bank's top management had any awareness of the existence or the irregular nature of the operations.

CRS-4

The inspectors, in particular, have directly investigated the following circumstances. In the ambit of interventions on behalf of Danieli & Co. Officine Meccaniche di Budrio (Udine) - relative to the designing and production of rolling mill installations in Iraq - it was learned that from the first contacts, set up by the corresponding branch in Udine, the offices of the Home Office established that a financing operation for 140 million DM would be channelled through the branch office in Atlanta in the ambit of the agreements, which Mr. Drogoul said existed, between the branch and the Central Bank of Iraq for the setting up of collateral deposits. This resulted from a telex dated February 2, 1989 sent from the finance section of the home office to the Central Bank of Iraq. The modes of operation that were followed would likewise fit into the practice adopted by the BNL of having the collateral deposits set up, with guarantee of easy credit terms correlated with contracts entered into by Italian businesses with Iraq, some through their foreign branches (Atlanta, London) for the purpose of avoiding the risk that other Italian firms that claimed credits disputed by Iraq might make good said deposits through legal channels.

The inspectors have likewise pointed out that, through a fax of April 17, 1989, a few days after the signing of the fourth agreement (April 8, 1989) an official at the financing department of the Home Office sent Mr. Drogoul two memorandums on the contents of the contracts entered into by Danieli and the Iraqi purchaser, "State Enterprise for Iron and Steel", contracts with regard to which the Central Bank of Iraq afterwards actually asked the Atlanta branch to issue letters of credit to Danieli.

The inspectors discovered, in addition, a telex of December 13, 1988, sent by the BNL's branch in Hong Kong to the Atlanta branch and, for their information, to the above-mentioned finance area as well as to the U.S. area in New York, in which reference is made to contacts that took place with the Centrifugal Casting Machine Co., Inc. concerning the possibility of granting advance funds on the exportation referred to in letter of credit no. 11758 for 26.3 million dollars, approved by the Atlanta branch upon order of the Central Bank of Iraq.

After having thus recalled that the responsibilities connected with the Atlanta case are the object of judicial investigations in the United States as well as in Italy, the speaker reports that last April 19 the U.S. judicial authorities, in the ambit of the criminal investigations concerning the facts that were pointed out at the Atlanta branch, issued to the BNL a subpoena (?) aimed at obtaining a copy of the report drawn up by those in charge of the Italian oversight following the investigative inquiries made at that branch from August 7 to November 10, 1989. The greatest amount of collaboration was given this request.

The Minister then recalls that concurrent with the investigations conducted by the Bank of Italy, the Federal Reserve Bank of Atlanta made an inspection of the coexisting branch of the BNL in the framework of the coordinated investigations of all the banking firms in the United States.

The scope of the inspection inquiries was limited to determining the extent of the unauthorized transactions, their cause, the corresponding violations of federal law and regulations and the branch's credit risk. The activity that was carried out included an analysis of the accounts, the documentation, the guidelines that were followed, the

CRS-5

operations, the internal controls, and the information that was sent to the Reserve Bank and to the home office and of the auditing functions.

The speaker observes at this point that the American authorities' results converge with the conclusions which the supervisory department of the Bank of Italy is reaching.

In particular, bearing in mind the level of risk existing in the branch's assets and the inefficiency of the internal controls, the situation at the time it was examined was evaluated by that authority as being wholly unsatisfactory.

It was shown that the instructions from the home office were systematically ignored and that the local management neglected every principle of prudent management by extending credit and acquiring funds for amounts greatly exceeding the limits of autonomy recognized by the home office.

The Federal Reserve expressed the opinion that the branch's unsatisfactory situation was able to be protracted in time also because of inadequate controls on the part of the Institute's home office and stated its intention of asking Bancoper for the advance preparation of a detailed program of actions to be embarked on in order to put the U.S. branches in order.

Then, dwelling on the business context in which the irregularities were verified, Minister Carli states that the anomalies that turned up, surely determined by fraudulent conduct, had been carried out in an organizational context of American culling, characterized by structural deficiencies in the system of controls. In particular: the procedures for verification of the accounting data were not adequately formalized; the branch's net worth (?) was not subjected to adequate analysis for the purpose of checking the consistency nor were any examinations done on the movements of the correspondence account that was maintained between the Atlanta branch and the Morgan, the treasury bank, through which almost all the operations done by this branch passed; the activity of oversight control entrusted to the internal auditing function appear not to have been very effective, since they were based on investigation techniques that were not sufficiently extensive; more in-depth controls could have been able to cause the data that were not proportional to the official operations of the branch to emerge and specific clues from which to go back to the irregular operations; a separate informational-accountable system was used by the branch, in addition to the official ones. Such a system was adopted by the branch through recourse to special programs, as well as the management of unofficial statements (?).

The speaker observes that since the irregular actions emerged, the extent of Atlanta's arbitrary activity has raised questions on the BNL's organizational form and on status of the internal controls. The investigations conducted by the Bank of Italy's inspectors brought to light the existence of dysfunctions even at the firm's general management.

The BNL has been for some time showing weaknesses in its organizational structure, for which the Banking Supervision Body had called for corrective action. The institute has tackled the reorganization demands and that of reducing costs in order to free up greater profit volumes. The measures taken have shown themselves to be, actually,

insufficient to solve the bank's problems and, furthermore, they were taken in a hasty manner and at the expense of an efficient system of internal controls, generating uncertainties and elevated risks in the transition phase. In this context Atlanta's actions took place.

The main shortcomings revealed in the last inspection along the lines of the organizational structure recently adopted are the scanty effectiveness of the activities of coordination between the diverse departments, especially as pertains to overseas, and the inadequacy of internal controls.

In the accounting system there emerged the lack of the necessary integration among the procedures introduced at diverse times; for the foreign branches the functionality of the same has been conditioned by the use of differentiated software, aimed in particular at satisfying the requirements of the individual nations.

Procedures, methodologies and insufficiently specified assignments of responsibility have weighed upon the effectiveness of the internal controls. With reference to the foreign activity, deficiencies connected to the absence of summary data concerning clients assisted by two or more units of the group were found. The same controls exercised by the internal inspectorate turned out to be inadequate and infrequent because of the continuous use of this structure for the performance of other tasks.

Minister Carli then proceeds to illustrate the tidying-up action set in motion by the BNL, dealing point by point with the interventions of capital, the organizational tidiness and with the arranging of the irregular credits.

Apocaps of the first point, he observes that in relation to the situation which came to be in the BNL group, the Bank of Italy invited the firm in September 1989 to opportunely take on initiatives aimed at recovering the complete administration of the foreign network and deemed it necessary to apply - as a prudential measure of an immediate nature - a net worth (?) coefficient linked to a business risk more restrictive than that in effect for ordinary banks; which provides for a double consideration of the assets that headed the foreign branches and of the assets held by the home office vis-a-vis the foreign participants. An assets requirement of over a trillion [currency not given] was determined.

For this latter purpose the BNL carried out interventions of recapitalization for a total amount of 2.017 trillion; 817 billion deriving from the increase of the share held by the Istituto Nazionale delle Assicurazione and the Istituto Nazionale della Previdenza Sociale; 1.2 trillion connected with a subordinate loan granted by the INA. A further contribution was supposed to have come from the bill, presently under examination by Parliament, concerning the reorganization of public banks.

In order to overcome the complex problems that characterize the bank's situation, as emerged following the oversight group's investigation, Bancoper has now initiated corrective measures aimed at reestablishing control of management and, more generally, at improving operational security.

In particular initiatives turn out to have been taken in the foreign section under the aspect of the information flow directed at the home office and concerning the evolution of the operation and of the risk; the limits of autonomy of the foreign branches have been reduced; the regulation of the U.S. branches; the structures entrusted with the inspection control are on the way to being strengthened.

However, more far-reaching interventions, among them the creation of an integrated information system extending to the entire business and to the group, which presupposes among other things, the homogenization of the survey on the activities of the foreign branches, takes no small amount of time; these involve a constant verification action by the oversight body in conjunction with the authorities of other countries, because of the jurisdiction aspects of these latter.

In a framework of reciprocal exchange of information necessary for the purposes of banking control, the U.S. oversight authorities were informed about the final results of the inspections carried out by the Bank of Italy and about the first interventions assumed by the BNL.

In the ambit of the measures initiated by the business, the speaker mentions the significant reform of the by-laws, deliberated by the special assembly of the BNL's participants, at the meeting on April 26, 1990. The text is characterized by an adjustment of the guidelines concerning the essential aspects of the operation, of the capital and the organizational structure to that of joint-stock companies.

The organizational structure retains at the top the figure of the president, by ministerial appointment, with specific powers; it provides for the corporate administrative bodies to be regulated in accordance with company plans and introduces, thus closely following the BNL's organizational order, the post of one or more managing directors, who head up the entire structure of the company's executive department.

With regard to the systematization of irregular credits, the Minister recalls that Bancoper, from the moment the irregular operations at the Atlanta branch surfaced, held it to be its duty to reconstruct the operations brought about by that branch; to establish a general criterion of conduct towards the third-party beneficiaries of letters of credit extended by the same branch, in the sense of meeting only the commitments resulting from documentation formally unexceptional and binding on the bank and subordinately to the issuance of affidavits on the nature of the merchandise: to bring to the attention of the concerned judiciary authorities all that has emerged.

According to the institute, the opening of a legal office with Iraq would have given the sole benefit of avoiding further residual payments influencing contracts, but in any case, it might have jeopardized the repayment of what had already been paid out, thus leaving the bank exposed to legal actions by the third-party beneficiaries and by the Iraqis themselves, with property, management and image consequences.

In this framework, since August 1989, two delegations from the bank have gone to Baghdad, but found, however, a substantial unwillingness on the part of the Iraqis to discuss the contracts that had been entered into with the Atlanta branch. The Ministers

of the Treasury, Foreign Affairs and Overseas Trade, as well as the Supervisory Body were kept informed of the contacts underway with Iraq.

In mid-December, 1989, after the Italy-Iraq inter-governmental talks, the Iraqi counterpart manifested a resumption of interest in the contractual definition of the matter.

The negotiations between the parties culminated in an agreement for the systematization of the credits in dispute [?], signed in Geneva on January 19 and 20, 1990, whose meliorative aspects regard, in the bank's evaluations, substantially the economic profile and the prospects of getting back the expenditure.

The Geneva understandings determined the sum of the credit still usable by the Iraqi purchasers, even following the substitution and renegotiation of some operations that had been started and not concluded. The parties agreed in particular to cancel two letters of credit to the General Motors Corporation (for 114 million dollars) and the letters of credit to Matrix Churchill, Ltd (for 70 million dollars).

The subsequent clauses of the agreement regulate in particular the use of the sums rendered altogether available in a way so as to favor Italian exports.

It was indeed established that one part of the above-mentioned quota, to be used for imports from Italy, be made available to the Iraqis solely for financing advance payments relative to contracts insured by SACE and financed by the bank, having a value of not less than a billion dollars.

As concerns the predictions in defense of the bank being reimbursed, the management reports that the commitment on the part of the Iraqis to maintain deposits at the BNL for nearly 100 million dollars subsists, on which the same BNL will pay interest at the market rate.

Minister Carli adds that the budget policy followed by Bancoper is also made a part of the framework of greater openness in management.

The institute closed financial year 1989 with an accountable loss of 498 billion, with reference to the choice of calculating the assets according to criteria more in line with market values. In particular, capital losses were registered on the securities being held for investment purposes as 416 billion and reserve funds of 232 billion in addition to those fiscally exempt, were realized as compared to the risk country [?].

However, let it be said that the operational gross income for 1989, reconstructed according to criteria that do not take into account the components of an unusual nature, shows substantial holding firm with respect to 1988.

After having recalled that in his appearance in December of last year before the Senate Finance and Treasury Committee he had also dwelled upon the steps taken at the international level to call the attention of the Supervisory Authorities to the risks inherent in operations that are carried out by banks in foreign markets, Minister Carli reports that the Basel Committee for Regulation and Oversight Practices, in subsequent sessions that were held between October 1989 and March of this year, was informed by the Bank of Italy

CRS-9

along the lines of the developments in the Atlanta affair for the aspects more directly pertaining to the control over banks with international scope.

Reflections are underway that are moved by the observation that it is no coincidence that cases of relevant losses that have concerned the major banks of the different countries have almost always been connected with operations of an international nature.

It is necessary on one hand to strengthen the internal controls exercised by the home office, making them more effective, and on the other, to develop operational cooperation between the national oversight authorities, leading to the principle of home country control, which is not under discussion; an application to make better use of the different capabilities of supervisors in the country of origin and in the host country.

In this framework it is the specific task of the oversight authorities to require the adoption by the banks of a good administrative and accounting organization and adequate internal checks. With the responsibility of the oversight authorities of the individual nations brought to an end, much progress could be obtained if the diverse control groups would discuss the possible contents to be inserted into a minimum standards list. To this effect, the Bank of Italy in November of last year made clear to the banking system the minimum requirements that must exist in the organization structure of the foreign section.

The importance of cooperation between the authorities of the diverse countries for the purpose of an effective supervision activity over the individual banks and banking groups was stated in the most authoritative way by the Basel Convention and is now recognized in most places.

The existing standards and agreements, at least within the G-10 countries, may be considered sufficient for carrying out the exchange of information. The problem is that of giving specific actuation to the principles of cooperation. A regular system of bilateral meetings would undoubtedly render oversight more effective.

On the point of concluding, the Minister furnishes some informative data on recent affairs that appear to concern the intercurrent credit relations between the Società delle Fucine di Terni and the local branch of the BNL.

The facts fit into the broader context of the judicial investigations underway into the supply of war materiel to Iraq.

According to the news reported by Bancoper, in December 1988, the executive committee deliberated, by proposal of Terni branch and within the framework of the assistance furnished to the public steel industry, on guarantees to the Ternian company for a total of 31 billion lira, regarding entering into an agreement with an Iraqi state enterprise for the supplying of forged steel. The bank's credit intervention would be split up (?) in the technical forms - widespread in international banking practice - of guarantees in favor of the customer either through advance payments or through the regular fulfillment of the contract.

In partial application of the credit opened for "Fucine" in 1989 a contract was executed for 3.3 billion lira which entailed a commitment for the BND of an aggregate

CRS-10

amount of 1.9 billion (681 million as advance payment bond, 1.3 billion as performance bond). The operation, according to the bank, is not included among those that were irregularly realized by the Atlanta branch and did not entail any financing in favor of the Iraqi authorities.

Indeed, from the reconstruction carried out by the firm, it is shown that on June 1, 1990 the sum of 661 million lira was accredited to the company, representing 20 percent of the amount of the contract in question. The sum had been acknowledged on March 3, 1989 by the Dresdner Bank of Cologne on the account of the Iraqi embassy in Bonn and the payment had been subordinated to the issuance, in favor of the same embassy, of a guarantee by the BNL under the form of an advance payment bond.

Another tranche for 1.3 billion lira was paid to "Fucine" on November 20, 1989 following the deposit by the Unione di Banche Arabe [Union of Arab Banks], by order of the Central Bank of Iraq, of the relative amount to the BNL. The Terni branch acknowledged the sum to the beneficiary after having verified the existence of the funds and having obtained from "Fucine", as integration of the prescribed currency declaration, an affidavit relative to the nature of the merchandise. The practice followed reflects the greater caution that was generally adopted by the BNL in the aftermath of the Atlanta actions for all the operations relative to transactions with Iraq.

The BNL furthermore relates a payment of 661 million lira, made on May 11, 1989 by check to the order of "Fucine", negotiated by the Iraqi embassy on its own account, maintained at the Banco di Roma [Bank of Rome] and consigned to the same firm. The check was remitted by the "Fucine" company to the drawee Bank with instructions to sign over the amount to the Terni branch of Bancoper. The sum, which reached the branch on May 14, 1990, was carefully set aside in a special account upon instructions from the home office of the BNL.

An analogous procedure was followed for another check for nearly 150 million, which Bancoper believes to presumably be referable to another consignment. The BNL has pointed out that the Terni office had negotiated for the client, beginning on February 16, 1990 and up until April 27, 1990, checks negotiated by the Iraqi embassy on the Bank of Rome for a total of 729,543 dollars. On this point Bancoper says that the connection of these payments with the described operation or with others is not known.

For completeness the BNL has also pointed out that on July 27, 1989 the Rasheed Baghdad had sent to the institute's Terni branch a documentary credit of 1.2 billion lira with request for confirmation [?]. On December 12, 1989, the home office, in relation to the situation of conflict with the Iraqi banks, would not authorize the assumption of the risk notwithstanding that the Rasheed had put the funds in on its own account at the BNL. On February 25, 1990 the Iraqi bank cancelled the documentary credit.

Minister Carli closes by pointing out that from the firm's reports it turns out that in early February of this year the assignments to "Fucine" were reduced to 1.3 billion lira, an amount correlated to the existing effective risk.

Senator Carta thanks the Minister for the ample report which sums up and furnishes a picture of the reports already made in the two branches of Parliament.

In thanking the Minister for the ample report he furnished to the Committee, Senator Colombo asks what the understandings of the Italian authorities are with regard to the BNL - Atlanta case and whether the Minister of the Treasury believes that the course of the administrative investigations are now concluded.

Minister Carli states that the oversight body is constantly in contact with the BNL and that there are some control operations by the Bank of Italy while the Minister of the Treasury is studying the changes to be introduced to the BNL's by-laws.

In the opinion of Senator Riva, the adjective "fraudulent," attributed by the Minister to the conduct of the BNL's representative in Atlanta explains little of what really happened. It is quite strange that no suspicions of any sort were aroused about the autonomy which the manager of that branch enjoyed in view of the immense amounts of money involved in the banking operations. One wonders, in other words, how it is possible that automatic market control mechanisms were not set off.

To this objection the Minister responds that the subject is very debated by the finance operators and that the control of these operations is very difficult to handle because of their complexities and their dimensions. The true nature of the operations is difficult to ascertain and often escapes the oversight bodies who are supposed to exercise a complex series of controls that could, however, harm the functioning of the entire system.

Senator Riva asks for clarifications on the treasury function bestowed by the Morgan Bank and, given the debit and credit operations of a constant and conspicuous flow of money, he wonders how's come the necessary control mechanisms were not set off.

Senator Carli emphasizes that the income and expenditures of money of the Morgan Bank balanced out.

Senator Gerosa asks the Minister what, more exactly, was the weak point in the BNL's structure.

The Minister explains that the bank has broadened operations enormously, but has not subsequently corrected the organization and the control mechanisms.

Senator Riva remarks that the mechanism of affidavits represents a useful form of coverage.

Minister Carli recalls that the same question was put to him a few years back during the so-called currency proceedings. Also on that occasion he replied that the big Italian contribution to the development of international trade was having built it on documents. To a further request by Senator Acquarone for clarification, the Minister confirms that the Morgan Bank intervened only as a treasury and that the flow of income and expenditures of money were balanced.

Senator Ferrara asks the Minister if there are not, therefore, mechanisms of defense against operations which, although seemingly regular, may have fraudulent ends.

CRS-12

The Minister emphasizes that the systems of control may be of various degrees and nature. Each system, however, has a cost also in terms of fraudulent use, thus, it is a matter, in short, of limiting this cost once the system is chosen.

Senator Garofalo asks for clarifications on the existence of a fund at the Atlanta branch of the BNL, whose nature has not been pinpointed by today's report by the Minister.

In Minister Carli's opinion a verification of the inspection groups would be timely before being able to speak of the nature of this fund which does not necessarily need to be fraudulent. He believes, however, that an analysis of his report and of the other documents furnished to Parliament may furnish data sufficient for a reply to this question.

Chairman Carta, thus invites the Committee to express itself on the future tasks, reminding it that the Chair believes that the initiation of a fact-finding inquiry in accordance with Article 48 of the Regulations is in order with a first hearing from the Bank of Italy's home office manager of oversight on credit affairs, and the general manager and president of the BNL.

Senator Colombo proposes the hearing of financial brokerage experts who are competent in both Italian and international systems.

After further participation by Senators Riva, Postal and Gerosa, the Committee agrees to proceed according to the plan outlined by the chairman, with the hearing from the general manager and president of the Banca Nazionale del Lavoro [BNL] and the Bank of Italy's home office manager of oversight.

The session ends at 5:05 p.m.

Translated by Wesley Edward Kerney
CRS - Language Services
October 5, 1990

Solon firm called part of pipeline for arms to Iraq

By KEITH EPSTEIN, KAREN HENDERSON and THOMAS W. GERDEL
STAFF WRITERS

WASHINGTON — For two decades in a one-story building in Solon, the dozen or so employees of Matrix-Churchill Corp. quietly went about their seemingly typical Midwestern business: selling machine tools.

The metal-molding high-tech lathes and grinders, made in Britain, were popular in the United States. The North American headquarters was, in the words of a top executive in England, "simply sales and service."

Federal authorities are saying that in recent years a customer of that sales and service was Saddam Hussein.

Iraq's leader had other uses for lathes and grinders besides building automobiles or tractor parts. Federal authorities said yesterday that the Solon firm was ultimately owned by Iraq and that the business served as a clearinghouse for Saddam's international procurement of machines to make weapons.

On Monday, federal agents sent workers home, sealed the doors and froze the company's bank accounts — the first seizure of an Iraqi asset since the shuttering of Iraqi Airways offices shortly after President Bush ordered a freeze of Iraqi assets on Aug. 2.

Matrix was "acting as purchasing and selling agents for Iraq," said Steven Hartkop, assistant agent in charge of U.S. Customs in Cleveland. A Treasury Department official in Washington, requesting anonymity, said the firm "has been identified as being involved in international weapons procurement."

Abdul Qaddumi, the company's secretary, responded, "These are lies." Qaddumi, a native of Jordan, said the firm restricted its business to selling tools and spare parts and repairing machines installed in the United States and Canada.

But interviews with government sources, records and previously published accounts suggest that the business at 5903 Harper Rd. was part of an extensive international network of companies, subsidiaries and agencies through which Saddam secretly built his daunting military arsenal.

SEE IRAQ/13-A

SEE SOLON/13-A

Iraq beefs up troops in Kuwait

FROM WIRE REPORTS

WASHINGTON — The Pentagon estimated yesterday that the number of Iraqi troops in and near Kuwait has swollen by 95,000 in the past two weeks and they appear to be holding their defensive posture.

In Paris, nine European nations called on the U.N. Security Council yesterday to impose an air embargo on Iraq and agreed to coordinate their air and ground forces in the Persian Gulf.

Defense and foreign ministers of the Western European Union urged the Security Council to quickly endorse closing Iraq's air routes to enforce the economic embargo imposed after the invasion of Kuwait.

The Security Council already has endorsed the use of naval force to back up the embargo.

Defense Department spokesman Pete Williams said the latest estimates were that 360,000 Iraqi soldiers are in the "Kuwaiti theater," up from 265,000 two weeks ago.

He also said Iraq has 2,800 tanks, 1,800 armored vehicles and 1,450 artillery pieces in the theater, although some tanks have been pulled back from the border with

Cult leader's son convicted on 4 counts of murder



RAYMOND A. WINBUSH: Cleveland State trustees to vote on a severance package for former university vice president.

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By JOHN
STAFF WRITER

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TENSION IN THE MIDDLE EAST

Solon

FROM/1-A

The company's president, identified by the Solon Chamber of Commerce as Safa al-Habobi, is identified by British officials as having direct ties to Hussein Kemal al-Majid, Saddam's son-in-law.

The son-in-law runs a key Iraqi defense firm, Nasr State Enterprise for Mechanical Industries, where al-Habobi is a top official. He oversaw the building of a weapons complex in which machines made by the Matrix parent firm in England were installed.

The Solon firm is directly involved in an effort to be used by the U.S. Commerce Department to build a fiberglass plant in Iraq. But there appears to be some question over whether the fiberglass was intended for reinforcing oil plants or motor casings in missiles.

During the 1980s, the defense firm run by Saddam's son-in-law bought foreign companies specializing in technology with military applications. In 1987, Baghdad-based Al-Arabi Trading bought a British firm, technology and defense equipment Group Ltd., which in turn bought Matrix-Churchill Ltd., based in Coventry, England.

Steve Brittan, Matrix operations director in Coventry, said: "There's a link (with the Iraqis) somewhere within the organizations, a tenuous link. That link's obviously the reason there's going to be an investigation" by U.S. authorities.

But he said the assertion that Matrix knowingly supplied Iraq with the ability to make weapons was "just not true."

But accounts published in Britain and

broadcast on BBC television, together with interviews, indicate that Matrix played a key role in helping build a large military manufacturing complex near Mosul, Iraq.

The Saad 16 complex cost Iraq \$100 million, some of which paid for Matrix machinery. The company also trained Iraqi workers in Coventry.

Businesses in scores of other western nations also have aided Iraq. The Coventry company's role in building Iraq's arsenal is exhaustively in the British press during the last month appears to highlight the dilemma of governments that seek to control the export of products that have a "dual use" — for pure commerce or for war.

"Much of their business appeared to be legitimate," said Hartkopf, the U.S. Customs agent in Cleveland.

For example, government sources said one of the first efforts by the Ohio company, after being acquired by the Iraqis, involved a project to manufacture high-precision tungsten carbide tools using a computer-controlled grinder.

The device could have numerous commercial applications such as making engine and transmission parts. However, some Commerce Department officials were concerned the grinder also could be used to make nuclear weapon components and parts for missiles.

The sources were unaware whether the project went forward.

The Ohio subsidiary's current effort involves a fiberglass manufacturing plant in Iraq. Qadumi said the Solon company was securing equipment for the plant and has obtained an export license from the Commerce Department. He said the fiberglass would be used as reinforcing material at petrochemical plants.

Among the concerns of some government

Iraq

FROM/1-A

Saudi Arabia. Two weeks ago there were 2,200 tanks.

"Iraq continues to improve its defenses, but nonetheless retains the capability to conduct offensive operations with very short notice," Williams said.

When asked if it appeared the Iraqi forces intended to move into Kuwait, which they captured Aug. 2, Williams replied, "I think you could conclude that that's what Williams also announced that a team from the guided missile cruiser USS Biddle stopped and boarded a Soviet cargo ship, the Proby Masherov, on Monday as part of the effort to block trade with Iraq.

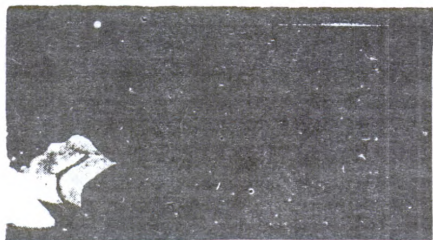
He said the boarding in the northern Red Sea was "routine" and conducted with the permission of the master of the Soviet vessel. He said the Soviet ship was permitted to proceed to the Jordanian port of Aqaba.

It was the first boarding of a Soviet vessel in the United Nations blockade. It did not produce a protest from the Soviet government.

At the United Nations, officials said the five permanent members of the Security Council had agreed that in an air embargo, planes on their way to Iraq would not be forced down but could be challenged. The officials said the Security Council may vote on the measure by next week.

The air blockade decision follows a dramatic rise in tensions between Europe and Iraq following raids last week by Iraqi soldiers on the diplomatic quarters of at least four nations in Kuwait. The Western European Union formally agreed Monday by the 12-nation group to force Iraq to expel Iraqi military aides and restrict movements of Iraq's diplomats in their capitals.

5 DAYS ONLY!



P.D.C.H. PETE COPELAND

for minority affairs, announces that he has taken a job as a lawyer, Ricardo Teamor; Mayor Michael R. White; and Gov.

ks with protesters

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Winbush has taken a position as assistant provost and director of the Johnson Black Cultural Center at Vanderbilt in Nashville, Tenn., where he was a faculty member and administrator before he came to CSU in August 1989.

"This position offers me a chance to return to an institution committed to providing greater access and success to students and faculty of color," Winbush said yesterday.

Winbush thanked his supporters and said he believed a structure was in place that would lead to "meaningful negotiations among the (CSU) students, faculty, staff, administration and community leaders." He said the negotiations should help CSU embrace minorities more than it had in the past.

Winbush said he was saving most of his comments on the matter for a speech he is to give tomorrow at the City Club.

SEE WINBUSH/9-A

wich, draws fire

othy F. Hagan, former chairman of a county Democratic Party, agreed.

"Arnold Pinkney is an angle-potter," Hagan said. "And he has decided to cast his lot with George Voinovich because he is looking for state business. It's a blatant effort on his part to be the chief minority with George Voinovich."

Other Democrats were less critical. "It would have been good to have Arnold on our side, but it doesn't damage our campaign," said Rep. Louis Stokes, D-21, of Shaker Heights, who is promised to deliver black votes for Celebrezze. Stokes said Celebrezze had personally sought Pinkney's backing.

A spokeswoman for Celeste said the governor was disappointed by Pinkney's endorsement of Voinovich. Pinkney formerly served as Stokes' campaign manager and worked on Celeste's 1982 and 1986 gubernatorial campaigns.

Pinkney is a former Cleveland

SEE PINKNEY/16-A



Arnold Pinkney

; walk the plank

as saying: "All money, assets and their revenues belonging to governments, institutions, companies and banks of countries that have taken arbitrary actions against Iraq are impounded."

The news agency did not say how much money might be involved, nor was the U.S. State Department able to provide an estimate, Margaret Tutwiler, a department spokeswoman, said in Washington. "It is not clear from the Iraqi statement in what form or against whom the action will be taken."

A Department of the Treasury spokesman said the extent of the property involved could not be determined until claims are filed. The United States, and other countries as well, froze Iraq's holdings abroad not long after Iraq invaded and occupied Kuwait on Aug. 2. According to the Iraqi News Agency, the new decree declares that action invalid.

Iraq's order to seize foreign assets is the latest in a series of tit-for-tat moves. President Saddam Hussein has made in an effort to counter the foreign pressure. In response to the trade embargo, he has withheld food from foreign refugees trying to get out of the country; in an effort to deter military attack, he has moved foreign hostages to potential target areas.

The decree's impact will vary from country to country. Britain, for example, has little in the way of assets in Iraq and is a net debtor. Several Japanese companies, on the other hand, are owed about \$4.5 billion by Iraq.

The United Nations, meanwhile, took steps to tighten the net around Iraq by broadening the blockade to include air cargo as well as shipping and overland commerce. A proposed resolution would subject to inspection at intermediate stops all flights into and out of the coun

SEE IRAQ/6-A

Lundgren claims God empowered him to kill Averys

By MAGGI MARTIN

STAFF WRITER

Jeffrey Don Lundgren turned a Lake County courtroom into his pulpit yesterday as he told a jury he was a religious prophet entitled by God to kill the Dennis Avery family because they were sinful followers who doubted the cult leader's words.

In a five-hour, Sunday sermon-style speech to jurors, Lundgren talked of visions and his endowed powers in what amounted to a personal appeal to persuade the six

Solon firm solely an Iraqi front, U.S. says

By KEITH C. EPSTEIN and THOMAS W. GERDEL

STAFF WRITERS

WASHINGTON — The suburban Cleveland firm seized by authorities Monday was "an Iraqi front" bought by middlemen for Saddam Hussein solely to conceal the acquisition of nuclear weapons technology, top U.S. Customs officials said yesterday.

Matrix Churchill Corp., a Solon machine tool company, was "purchased by Iraqi interests for the specific purpose of illegally acquiring critical weapons technology," said Customs Commissioner Carol Hallett. She described the firm as "an Iraqi front."

Other Customs officials said the Solon firm was able to aid Saddam's budding nuclear weapons program by making connections with U.S. companies and by cloaking the ultimate destination for extremely versatile machinery made in Britain that can be used to manufacture arms.

"In the old days, the bad guys were trying to directly export," explained John Keith, a senior special agent at Customs. "But if they buy a company in, say, Solon, that company can more easily obtain things that can be ultimately shipped out."

Added Keith: "The name of the game here is concealment."

SEE SOLON/6-A

April 1989 and persuaded his followers to bury them in a common grave at the Kirtland farmhouse shared by his cult.

As the final witness in his defense, Lundgren claimed he was endowed by God with the power to kill the Averys because they were wayward sinners with rebellious children. He said his followers would have been prevented from meeting God face to face if the Averys had been allowed to live.

In a statement that lacked the fire and brimstone Lundgren is said to have displayed during countless

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**ORIGINAL
MATTRESS**

Solon

FROM 1-A

Customs officials said they received a tip about the Solon company's role, now under examination by a federal grand jury, nearly a year before Iraq's bid for "acquisitions" by Iraqi "go-betweens," said John Hensley, the Customs Service's chief enforcement official.

Not so coincidentally perhaps, Matrix Churchill's president, Safa al-Habobi, also is an official with a key Iraqi defense firm run by Saddam Hussein's son-in-law. The defense firm, Nasr State Enterprise for Mechanical Industries, oversaw the building of a daunting weapons complex near Mosul, Iraq.

Federal grand jury officials say the role played by the Solon affiliate of the Baghdad manufacturer Matrix Churchill Ltd. has become part of a larger grand jury investigation in Atlanta, though that inquiry is focused primarily on the Atlanta branch of an Italian bank.

The Banca Nazionale del Lavoro lent Iraq \$3 billion for arms-related purchases without the approval of the bank's head office, the Italian government, which owns the bank, or U.S. authorities, according to interviews and previous press accounts.

At least \$16 million from the bank was used to fund efforts spearheaded by Matrix Churchill Corp. to fund Iraq's bid for a large-scale weapons plant. Customs officials last year the Iraqi credits extended by its bank were "irregular."

In another development related to arms deals and Iraq, Customs officials yesterday made two arrests in Palm Beach, Fla., in connection with an attempt to export high-tech missile guidance system components illegally to South Africa. Authorities believe the components ultimately were destined for Iraq.

Until Monday, the Solon firm had been Matrix work-crafts and the doors, drove off with the company cars and froze the corporate bank accounts, the 12-employee Solon firm operated out of a nondescript one-story building at 5903 Harper Rd.

Nothing was manufactured at the location, and the

operation was touted as strictly sales, service and spare parts for customers in the United States and Canada. Abdul Qadumi, the company's secretary, denies that the firm was doing Saddam's bidding.

Hensley, the Customs agency's assistant commissioner for enforcement, said yesterday the firm "clearly was doing things other than for business interests of a normal nature."

He said, with business associates of Matrix Churchill suggest the firm played a role as matchmaker between Iraqi interests and U.S. know-how — often on projects that could have been purely commercial endeavors or, as authorities say, arms-related.

In one instance, Matrix Churchill officials acted as a go-between for an Iraqi company and an Alabama firm bidding to build a carbide cutting tool plant in Iraq.

"They introduced us to the company in Iraq two years ago, during the war with Iran," said Hensley. He said that the XYZ Options, Inc. near Tuscaloosa, Ala. XYZ built the plant, procured equipment and trained workers.

Muscarella said he had never heard of Banca Nazionale, the bank which financed the \$14 million project with a letter of credit, but characterized the effort as a normal business deal.

The Alabama company's employees supervised construction for at least a year, and one XYZ official was able to escape several days after the Kuwait invasion. At the time, another 10-member team was poised to train in another effort, Matrix Churchill was project engineer for a fiberglass plant that seemed, to some of those involved, aimed at producing fiberglass for auto parts, reinforcing oil plants, and other commercial products, not military applications such as strengthening missile casings.

Albert Lewis, president of Glass Inc. International, of Chino, Calif., which was involved with Matrix Churchill in the fiberglass project, said he could not comment because he was not involved in the project.

Matrix Churchill also is tied to a failed attempt by Iraq to buy a USX Corp. steel plant in Baytown, Texas, two years ago. "We dealt with Iraqi officials directly," said USX spokesman Ernie Glenn. Of Matrix Churchill's role, he said: "They were serving as an advisor to the Iraqi government."

government spokesman Ibrahim

INSIDE

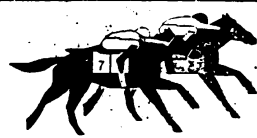


NINTENDON

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SEE IRAQ/4-A

U.S. had suspicions about Solon company, parent firm

By KEITH C. EPSTEIN

PD BUREAU

WASHINGTON — For at least one year federal authorities harbored suspicions but were unable to make a move against a Solon company believed to be a key link in a network of Iraqi companies arranging exports to Baghdad's military industries.

The government's hands were tied until the invasion of Kuwait and President Bush's Aug. 2 order to freeze Iraqi assets.

For at least as long, British authorities were unable to do anything about Iraqi businessmen they suspected of involvement in the procurement of sensitive equipment for Iraq.

Then, on Monday — the same day the U.S. seized Matrix-Churchill Corp. in Solon — the British Home Office expelled 23 Iraqis from the country. Among them: An

executive with links to the parent company that owns Matrix.

A Foreign Office spokesman said the British expelled Anees Mansour Wadi, a director of four British companies linked to Matrix parent TMC Engineering group, because his "continued presence was not conducive to the public good for reasons of national security."

In both cases, governments suddenly began cracking down on a problem long troubling their national security experts and were able to take action with serious consequences — even though they were unprepared to accuse anybody of breaking any laws.

"We've done nothing illegal," said Abdul Qaddumi, the Solon company's secretary. Qaddumi, a Jordanian-born American, said the company's three British and

SEE SOLON/5-A

By PATRICK J. SLOYAN
NEWSDAY

WASHINGTON — Under the cover of night, trucks from Baghdad and Basra began hauling ammunition, fuel, water and other supplies to 100,000 Iraqi troops poised on Kuwait's border.

But a U.S. KH11 satellite, using its infrared system and a system that magnifies starlight, picked up the telltale movement between dusk of July 27 and dawn of July 28.

For Army Gen. Colin Powell, chairman of the Joint Chiefs of Staff, and William Webster, director of the Central Intelligence Agency, those trucks were the clincher, proof an invasion was imminent, a senior Pentagon official said.

"It was the logistics trail Iraq needed for an invasion of Kuwait," he said. "We knew Saddam Hussein was lying (about invading)."

Their warning was not heeded by the White House, which in the days and months before the invasion had pursued a policy aimed at building stronger diplomatic and economic ties with Saddam's government.

Now, in its dusty wake, the invasion has left shattered a 9-year-old

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TENSION IN THE MIDDLE EAST

Solon

FROM/1-A

nine American employees "pay the taxes and are innocent people."

But Pentagon officials and members of the intelligence community have for years warned of the military potential for even legal sales of U.S.-made high technology such as Matrix-Churchill's computerized machine tools, which can shape metal with an accuracy of 10 one-thousandths of an inch.

The United States and many allies have been preoccupied with the task of cracking down on the export of such other weapons or arms parts, not machine tools. Basically machines that make other machines. As such, machine tools can play important roles in making auto parts — or missile parts.

At a trade fair last year, British-based Matrix-Churchill Ltd., the manufacturer, also Iraqi-owned, showed participants by demonstration how its machine tools could shape chess pieces from brass. U.S. officials say their equipment has also been used for less innocuous tasks.

In the United States, such "dual use" technology enjoys a free flow even to potential foreign enemies because the Commerce Department has approved otherwise questionable licenses for companies whose products appear to have commercial applications.

Similar names hair-raising for Solon manufacturer

BY MARK NIQUETTE
STAFF WRITER

There are two companies with the name "Matrix" in Solon. Neither is very happy today.

Matrix Essentials Inc., a manufacturer of hair-care products, has been confused recently with Matrix Churchill Corp., the company down the street suspected of assisting the shipment of sensitive, high-tech machine tools to Iraq.

U.S. Customs Service officials, who participated on a raid to seize the assets of Matrix Churchill on Monday, said Matrix Churchill was a front to assist Iraq in obtaining nuclear weapons technology.

"We are not sending guns to Iraq. We're not even sending shotguns," said Julie Montan, a spokeswoman for Matrix Essentials Inc.

Workers at Matrix Essentials have been the targets of dispar-

ing remarks, trucks bearing the Matrix name have been followed, and suppliers have questioned whether they should do business with the company, Montan said.

"You wear a shirt that says 'Matrix,' and people get the impression you are some sort of evil person," said David Pejstka, a production manager.

The problem, according to Montan, is that while Matrix Churchill has only 12 employees, Matrix Essentials has 750 and sells products and the closing of News reports of the closing of Matrix Churchill have been referring to the company simply as Matrix, helping to create the confusion.

"We even got a call from the New York Times yesterday wondering if we're shipping stuff to Iraq," Montan said. "We work hard to build a good reputation, and we don't want that to come tumbling down over this."

before an arms control subcommittee earlier this year.

Officials say the practice continues, often over the objections of the government's own national security experts, and overlooks the fact that leaders such as Saddam Hussein increasingly have tried to purchase not simply bomb parts but machines to make the machines to make the bombs.

Stephen Bryan, the Pentagon's deputy undersecretary of defense for trade security policy, during the Reagan years, said the "dual use" technology could be "potentially dangerous high technology, to such nations as Iraq, Egypt and Argentina."

Bryan, writing in the publication "National Intelligence," said that the U.S. and NATO allies had even "allowed and aided the development and stockpiling of major chemical warfare capabilities in Iraq — the same potential now haunting U.S. troops dispatched to the gulf."

During the last five years, the Commerce Department has granted 498 licenses for exports of sensitive U.S. technology to Iraq, worth some \$720 million. All of the licenses are kept secret for primary reasons, the Commerce Department said.

Among approved exports to Iraq are known to be parts for oil and gas machinery, airframe and helicopter parts, tire-making machines and other equipment.

Until the government seized Matrix-Churchill, essentially putting it out of business, the Iraqi-owned company sold grinders, lathes and brooked deals between Iraq and U.S. companies to build cutting tool and fiberglass factories.

But federal authorities say the company was a central U.S. component in an array of linked companies throughout the West, a network run by a handful of Iraqis working for Saddam's son-in-law. British officials say they have identified at least 20 companies in the web.

Saudis stop oil supplies

NEW YORK TIMES

PARIS — Saudi Arabia yesterday stopped all its oil deliveries to Jordan, which have long constituted half of Jordan's daily supply of oil, Arab oil executives said.

Dealing a harsh blow to the Jordanian economy, which has been weakened by the Gulf crisis, Saudi Arabia notified Jordan that it was withholding the oil because it had not received payments, executives said.

Despite the notification, diplomats here and in the Gulf said the oil cutoff was an expression of Saudi anger at Jordan, where popular sentiment has been running strongly in favor of President Saddam Hussein of Iraq since he invaded Kuwait Aug. 2.

In normal times, Saudi oil shipments to Jordan have been run at an average daily rate of 35,000 barrels, worth \$1 million a day. Jordan's oil consumption, prices, Jordan consumed 70,000 barrels of oil a day. Western oil executives said Saudi had forced a substantial reduction of the flow of oil through the Pipeline, and that the reduction had been especially sharp since the Gulf crisis.

Even though some Arab oil industry officials insisted that the decision was made for economic reasons, many Arab diplomats

Office of the President

September 19, 1990

The Honorable John Joseph Moakley
Chairman
Committee on Rules
U.S. House of Representatives
Washington, D.C. 20515

RE: The Gonzalez Amendment to H.R. 5269

Dear Chairman Moakley:

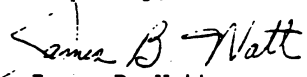
The Conference of State Bank Supervisors strongly supports the amendment proposed by Chairman Gonzalez to the crime bill, H.R. 5269. Accordingly, we ask that you and the members of the Rules Committee fashion a rule that provides for the floor consideration of this necessary and timely amendment.

The Conference of State Bank Supervisors represents the state officials that charter, examine, supervise, and regulate the over 9000 state banks. In addition to domestic banks, state supervisors regulate the activities of 557 foreign bank branches or agencies that hold nearly \$625 billion in assets.

Due to an apparent oversight, foreign bank branches and their employees are not subject to the federal criminal sanctions for crimes such as fraud, theft, embezzlement, and bribery. These institutions should be subject to federal as well as state criminal prosecution. The Gonzalez amendment squarely addresses this omission.

We appreciate your attention to this matter and your support of effective bank supervision.

Sincerely,


James B. Watt
President

CONFERENCE OF STATE BANK SUPERVISORS

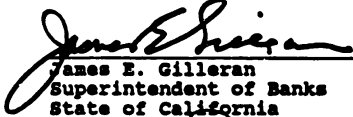
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Joint Statement of Principles on the Coordination of Applications for Offices, Examinations, Enforcement Actions, and the Exchange of Information on Foreign Banking Corporations.

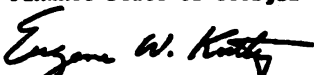
June 1, 1990

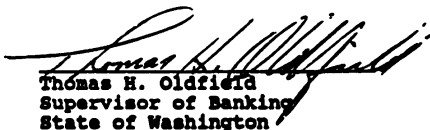
1. This Statement is issued jointly by the State Banking Regulatory Authorities of California, Florida, Georgia, Illinois, Michigan, New York and Washington (Authorities).
2. The Authorities recognize the importance of greater communication and coordination on situations of mutual regulatory concern regarding foreign banking activities in the United States in order to more effectively assess such situations and implement appropriate actions, if necessary. At the same time, the Authorities are aware of the need to preserve the confidentiality of information exchanged in this context, subject to Freedom of Information Laws, and to make certain that the information is used only for legitimate regulatory purposes.
3. Accordingly, the Authorities hereby agree in principle to coordinate the supervision and regulation of foreign banking entities in the United States and will endeavor to observe the following principles and practices:
 - (a) To implement procedures whereby each Authority will exchange information regarding its experience with an Applicant Bank when applications are filed in other states for foreign banking offices (Agencies, Branches and Representative Offices). This information would include financial condition, rating assessment from latest Report of Examination, home country supervision, parent bank supervision, business practices, and compliance with state and federal laws.
 - (b) To implement procedures whereby each Authority will attempt to coordinate its examination schedule of foreign banking offices with the other appropriate Authorities within the framework of: (1) existing statutory requirements and (2) special needs relative to policy or problem situations.
 - (c) To implement procedures whereby when one Authority contemplates taking an enforcement action against a foreign bank, notification would be made to the other Authorities.
 - (d) To implement procedures whereby, when one Authority initiates a criminal referral pertaining to an officer or employee of a foreign bank, the other Authorities will be so advised.

- (e) Each Authority will treat the information obtained from the other Authorities as privileged and confidential to the extent the information is privileged and confidential in the hands of the originating Authority. No Reports of Examination, in full or in part, shall be released to any person or entity that is not a party to this agreement without the written consent of the Authority which conducted the examination.
- (f) Each Authority assures that the information will be used for legitimate supervisory purposes and that no unilateral supervisory action against a foreign bank would be taken based solely upon the information.

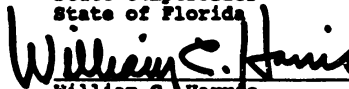

James E. Gilleran
Superintendent of Banks
State of California



E.D. "Jack" Dunn
Commissioner of Banking &
Finance State of Georgia


Eugene W. Kuthy, Commissioner
Financial Institutions Bureau
State of Michigan


Thomas H. Oldfield
Supervisor of Banking
State of Washington


Gerald Lewis
State Comptroller
State of Florida


William C. Harris
Commissioner of Banks
& Trust Companies of
Illinois


Jill M. Considine
Superintendent of Banks
State of New York

EX-101A1C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

FILED IN CLERK'S OFFICE
U.S.D.C. - Atlanta

OCT 1 21989

BANCA NAZIONALE DEL LAVORO,

Plaintiff

v.

CHRISTOPHER DROGOUL and
PAUL VON WEDEL,

Defendants

LUTHER D. THOMAS, Clerk
By: *LG* Deputy Clerk

CIVIL ACTION NO.

1:89-CV-2319
-HTW

COMPLAINT

Plaintiff BANCA NAZIONALE DEL LAVORO ("BNL") makes and files this Complaint against Defendants Christopher Drogoul ("Drogoul") and Paul Von Wedel ("Von Wedel") (collectively "Defendants"), and states as follows:

PARTIES AND JURISDICTION

1. BNL is a banking institution organized under the laws of Italy with its principal place of business in Rome, Italy. BNL conducts business within this district through its international bank agency (the "Atlanta Agency") licensed by the Georgia Department of Banking and Finance.

2. Drogoul is a citizen of the State of Georgia and of this district. Drogoul is personally subject to the jurisdiction of this Court. Von Wedel is a citizen of the State of Georgia and of this district. Von Wedel is personally subject to the jurisdiction of this Court.

3. This Court has subject matter jurisdiction over this matter pursuant to 28 U.S.C. §1332 because it is a controversy between a citizen of a foreign state and citizens of this state in which the matter in controversy exceeds \$50,000, exclusive of interest and costs. This Court further has jurisdiction over this matter pursuant to 18 U.S.C. §1964 and the doctrine of pendent jurisdiction.

4. Venue is proper in this Court because Defendants reside in this district and further because the claim arose in this district.

BACKGROUND INFORMATION

5. During the period from 1984 through August, 1989, Drogoul was employed by BNL as First Vice President and Manager of BNL's Atlanta Agency. Drogoul was continuously employed in that position at all times relevant to this Complaint.

6. During the period from 1984 through September, 1989, Von Wedel was employed by BNL as Vice President of BNL's Atlanta Agency. Von Wedel was continuously employed in that position at all times relevant to this Complaint.

7. Through its Atlanta Agency, BNL conducts various banking activities, as authorized by the Official Code of Georgia Annotated ("O.C.G.A.") § 7-1-710 et. seq. The Atlanta Agency is engaged in both interstate and international commerce, and it is subject to regulation and examination by both the Board of Governors of the Federal Reserve System and the Georgia Department of Banking and Finance.

8. As First Vice President and Manager of BNL's Atlanta Agency, Drogoul oversaw and directed the activities of the Atlanta Agency. He had ultimate responsibility for accurately reporting those activities both to BNL's offices in Rome and New York and to the responsible state and federal regulatory authorities. In addition, as First Vice President and Manager of BNL's Atlanta Agency, Drogoul owed fiduciary duties of loyalty and due care to BNL. As Vice President of BNL's Atlanta Agency, Von Wedel had responsibility for overseeing and directing the letter of credit operations of the Atlanta Agency and for accurately reporting those activities. In this capacity, Von Wedel also owed fiduciary duties of loyalty and due care to BNL.

9. At a time unknown to BNL, Defendants, acting in concert with others whose identities are not currently known to BNL, began a pattern of unauthorized and illegal conduct designed to defraud BNL and to enrich the Defendants. This pattern of conduct included at least the following:

- (a) Defendants negotiated and executed, purportedly on behalf of BNL, a series of unauthorized credit facilities and loan agreements with various commercial banks in Iraq, the Iraqi Ministries of Trade and Industry, the Central Bank of Iraq, and other entities in the United States and other countries. Pursuant to these credit facilities and agreements, Defendants purported to commit BNL to extend credit in various forms to these various entities.

- (b) The loan agreements and credit facilities negotiated and executed by Defendants were outside of the scope of their actual or apparent authority to act on behalf of BNL or BNL's Atlanta Agency. Defendants were aware of this fact at the time that they negotiated and executed the facilities and agreements, but they failed to disclose either the existence of the facilities and agreements or their terms to the appropriate officials of BNL.
- (c) The loan agreements and credit facilities purported to obligate BNL to extend credit to the Iraqi banks, the Iraqi Ministries of Industry and Trade, and other entities at interest rates, fees, and other compensation below the prevailing market rates for such loans, a fact that was known or should have been known both to Defendants and those acting in concert with them.
- (d) Following the negotiation and execution of the unauthorized loan agreements and credit facilities, Defendants and those acting in concert with them caused the Atlanta Agency to implement the loan agreements through various devices, including the issuance of unauthorized letters of credit, confirmations of letters of credit issued by other banks, and discounting of deferred payment letters of credit. Through these activities, Defendants and those acting in concert with

them have either disbursed funds or purported to commit BNL's Atlanta Agency to disburse funds in an amount believed by BNL to exceed two billion dollars.

- (e) Defendants and others acting in concert with them further arranged for direct transmittal of funds from BNL's Atlanta Agency to accounts that the Central Bank of Iraq or other entities maintained at other banks throughout the world. BNL understands that some of these transmittals were to be treated as loans or advances. These transmittals, however, were not authorized by the appropriate officials of BNL and were not made in accordance with the terms of the loan agreements and credit facilities negotiated and executed by Defendants.
- (f) Following the execution of the credit facilities and loan agreements, Defendants and others acting in concert with them engaged in a conscious, deliberate, and widespread effort to conceal the existence of the agreements and facilities and the actions of the Atlanta Agency taken pursuant to the agreements and facilities from the appropriate officials of BNL, BNL's internal and outside auditors, and the state and federal regulatory officials. These actions included, but were not limited to: (1) maintaining separate and secret

books and records for the unauthorized transactions;
 (2) concealing the secret books and records from the appropriate officials, auditors, and examiners; and
 (3) preparing, maintaining, and disseminating to officials at BNL and to governmental regulatory agencies materially false and misleading financial information about the Atlanta Agency and its operations.

- (g) Defendants further engaged in other unauthorized and illegal activities, including purporting to commit BNL to fund various commodity exports to foreign countries secured only by the commodities shipped, purporting to agree to discount drafts under letters of credit issued by commercial banks at rates far below market rates, and purporting to commit BNL's Atlanta Agency to add its confirmation to letters of credit issued by various banks in foreign countries. Furthermore, Defendants purported to enter into oral commitments with various persons and entities, allegedly on behalf of BNL. Defendants and those acting in concert with them also engaged in a pattern of conduct and activity designed to conceal these actions from the appropriate authorities within BNL.

10. As a direct and proximate result of the actions of Defendants and others acting in concert with them, BNL has suffered substantial damage in an amount as yet unquantified, but

believed to exceed several million dollars. In addition, BNL suffers the threat of immediate and irreparable injury from the continuing effects of the various actions initiated by Defendants and those acting in concert with them.

FIRST CLAIM - BREACH OF FIDUCIARY DUTY

11. BNL incorporates by reference the allegations set forth in paragraphs 1 through 10 above as fully as if set forth verbatim herein.

12. The actions of Defendants constitute a breach of their fiduciary duties of loyalty and due care, as well as other fiduciary duties owed to BNL by virtue of their positions as First Vice President and Manager of the Atlanta Agency and Vice President of the Atlanta Agency.

13. Defendants' violation of their fiduciary duties to BNL has directly and proximately caused damage to BNL in an amount as yet undetermined, which amount is believed to be in excess of several million dollars. In addition, Defendants' violations of their fiduciary duties are continuing to cause damage to BNL and will continue to do so for the foreseeable future.

14. Defendants violated their fiduciary duties intentionally and willfully, and with a reckless disregard for the consequences of their actions upon BNL. Accordingly, BNL is entitled to recover punitive damages in an amount sufficient to deter Defendants from future violations.

SECOND CLAIM - COMMON LAW FRAUD

15. BNL incorporates paragraphs 1 through 9 above as fully as if set forth verbatim herein.

16. Defendants have defrauded BNL through their actions and through their misrepresentation of financial records and information to BNL. Specifically, Defendants made or caused others acting in concert with them to make materially false and misleading statements to BNL regarding the financial condition and operations of the Atlanta Agency. Defendants also concealed the true financial condition and operations of the Atlanta Agency from BNL in order to further and conceal their unauthorized and illegal activities.

17. Defendants were aware that the false and misleading statements they made and caused to be made were false. Defendants made and caused the statements to be made in order to deceive BNL.

18. BNL was entitled to rely, and did rely, upon the truth of the statements Defendants made or caused to be made regarding the financial condition and operations of the Atlanta Agency.

19. As a direct and proximate result of the fraudulent conduct of Defendants and others acting in concert with them, BNL has been damaged in an amount yet to be determined, which amount is believed to exceed several million dollars. In addition, as a direct and proximate result of such fraudulent conduct, BNL will continue to be damaged for the foreseeable future.

20. Defendants' fraudulent conduct was undertaken intentionally, willfully, and with reckless disregard for the consequences of the fraudulent actions upon BNL. Accordingly, BNL is entitled to punitive damages in an amount sufficient to deter Defendants from such conduct in the future.

THIRD CLAIM - VIOLATION OF 18 U.S.C. § 1962

21. BNL incorporates paragraphs 1 through 10 above as fully as if set forth verbatim herein.

22. Through the actions described above, Defendants and those acting in concert with them have engaged in a pattern of racketeering activity, including mail fraud and wire fraud. Defendants and those acting in concert with them have engaged in repeated uses of the mails and interstate and international electronic wire facilities and telephone lines in furtherance of their scheme to defraud, including (1) making false and misleading statements in connection with the negotiation, execution, and implementation of the unauthorized and illegal loan agreements and credit facilities described in more detail above, (2) submitting materially false financial information regarding the business and operations of the Atlanta Agency to BNL's New York and Rome offices, including monthly and periodic reports and statements from the Atlanta Agency to these offices that materially misstated the financial condition and operations of the Atlanta Agency during 1987, 1988, and 1989, (3) making false oral statements to customers and others purporting to commit BNL to

various transactions, (4) transmitting telexes, telecopies, and letters implementing the various loan agreements and credit facilities, and (5) executing and implementing the other unauthorized and illegal transactions described above.

23. Defendants and those acting in concert with them constitute an enterprise engaged in interstate commerce. This enterprise was an association-in-fact engaged in the business of making unauthorized and illegal loans and entering into unauthorized and illegal business transactions for the benefit of Defendants and those acting in concert with them. This enterprise used the name and resources of BNL's Atlanta Agency to further the business of the enterprise.

24. Further, BNL's Atlanta Agency is an enterprise engaged in interstate commerce or activities which affect interstate commerce. BNL's Atlanta Agency is ongoing and has an existence distinct from the pattern of racketeering activity alleged herein.

25. Defendants were employed by or associated with BNL's Atlanta Agency and the association-in-fact described in paragraph 23 above. Defendants conducted or participated, directly or indirectly, in the conduct of affairs of BNL's Atlanta Agency and the association-in-fact through the pattern of racketeering described above in violation of 18 U.S.C. § 1962(c).

26. Defendants and those acting in concert with them have further conspired, in violation of 18 U.S.C. § 1962(d), to conduct



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the interstate enterprise described above through the racketeering activity described above.

27. BNL has suffered injury to its business and property by reason of the violations of 18 U.S.C. § 1962(c) and (d) described above. BNL is entitled to treble damages, in an amount to be shown at trial, and to the recovery of its reasonable attorneys fees for bringing and prosecuting this action.

FOURTH CLAIM - VIOLATION OF O.C.G.A. § 16-14-1

28. BNL incorporates paragraphs 1 through 10 and 22 through 27 above as if fully set forth verbatim herein.

29. This Count arises under the Racketeer Influenced and Corrupt Organizations Act of the State of Georgia, O.C.G.A. § 16-14-1, et seq.

30. The actions of Defendants constituting mail and wire fraud as specified in paragraph 22 above constitute "racketeering activity" as that term is defined in 18 U.S.C. § 1961(1)(B) and as such constitute racketeering activity under O.C.G.A. § 16-14-3(3)(A)(xxix).

31. Upon information and belief, Defendants and those acting in concert with them have, through the pattern of racketeering activity described more fully in paragraph 22 above, acquired personal property or money for their personal benefit, in violation of O.C.G.A. §16-14-4(a).

32. Defendants and those acting in concert with them have conducted an enterprise through a pattern of racketeering activity

within the meaning of O.C.G.A. § 16-14-4(b), as described more fully in paragraphs 23 and 24 above.

33. Defendants and those acting in concert with them have further conspired to violate the provisions of O.C.G.A. § 16-14-4(a) and (b), thereby violating O.C.G.A. § 16-14-4(c).

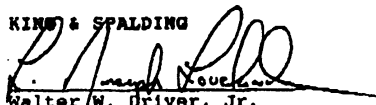
34. As a direct and proximate result of defendants' violation of O.C.G.A. § 16-14-4(a), (b), and (c), BNL has been injured in its business or property in an amount to be shown at trial.

35. Defendants are liable to BNL for treble damages, together with all costs of this action, plus reasonable attorneys' fees as provided by O.C.G.A. § 16-14-6(c).

WHEREFORE, BNL prays that it recover from Defendants, jointly and severally, damages in an amount to be shown at trial, punitive damages on its First and Second Claims, and treble damages and attorneys' fees on its Third and Fourth Claims. BNL also prays that it receive such other and further relief as the Court may deem just and proper.

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